No. 7466

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

ALFRED G. WILKES, L. BYRON SIENS, JOHN McKEON, ROBERT McKEON, MAURICE C. MYERS, WILLIAM J. CAVANAUGH, FRED SHINGLE and HORACE J. BROWN,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

POINTS AND AUTHORITIES ON BEHALF OF APPELLANTS, JOHN McKEON AND ROBERT McKEON.

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THE INDICTMENT.

On December 4, 1931, an indictment was presented in the United States District Court for the Southern District of California, Central Division, against eighteen defendants, among others the appellants herein, John McKeon and Robert McKeon.

The indictment contained fifteen counts, five of which were dismissed by the court. During the trial the indictment was dismissed as to three of the defendants. At the conclusion of the trial several defendants were found not guilty on all counts and some

were convicted on some of the counts. The appellants herein, John McKeon and Robert McKeon, were convicted *solely* upon the fifteenth count and found *not guilty* upon all the other counts.

The fifteenth count of the indictment charged the defendants with having engaged in a conspiracy to commit an offense against the United States, to wit, to conspire to violate the mail fraud statute—and cause to be placed in the postoffice establishment certain mail matter addressed to persons residing within the United States. (R. 60-61.)

When the government rested its case (R. 686-692) and later at the conclusion of all of the evidence (R. 1261-2) motions to dismiss the indictment and for the entry of a verdict of not guilty with respect to the defendants therein, John and Robert McKeon—indeed as to all of the defendants—were made on the ground that there was no evidence to support any of the charges made in the various counts of the indictment. Each of these motions was denied as to said two defendants, as well as to others, and as to them the trial proceeded to a verdict. From the judgment entered upon the verdict of the jury finding them guilty on the fifteenth count of the indictment, the defendants John McKeon and Robert McKeon have prosecuted this appeal.

For the purposes of this appeal it is only necessary to direct the court's attention to the first and fifteenth counts contained in the indictment, the first however only because its allegations by reference are incorporated in the fifteenth count and made part thereof.

In the fifteenth count of the indictment it is alleged that from January 1, 1924, and continuously to and including the 15th day of December, 1930, at Los Angeles, as well as at other places, the defendants conspired to commit certain offenses against the United States, to-wit, that said defendants would feloniously conspire

> "to devise a scheme and artifice to defraud and to obtain money and property by means of false and fraudulent pretenses, representations and promises from those persons described and named in the first count of this indictment as the persons to be defrauded, and for the purpose of executing such scheme and artifice, to place and cause to be placed in the post office establishment of the United States letters, circulars, advertisements, newspapers, bulletins and other mail matter addressed to various and sundry persons residing within the United States, the names and addresses of said persons other than as stated in the preceding counts of this indictment being to the grand jurors unknown." (R. 60-61.)

The first count.

In the first count referred to it is alleged that from January 1, 1924, until and including December 15, 1930, at Los Angeles and elsewhere, the defendants devised and intended to devise a scheme and artifice to defraud Italo Petroleum Corporation of America and certain individuals including that

> "class of persons who should be solicited to purchase and who should purchase the stock of the Italo American Petroleum Corporation and the Italo Petroleum Corporation of America * * *

hereinafter called the persons to be defrauded, and to obtain money and property from the said persons to be defrauded by means of false and fraudulent statements and promises hereinafter set forth." (R. 27-8.)

And that the fraud should be committed

"through, by and under their own names and the names of Italo American Petroleum Corporation and Italo Petroleum Corporation of America." (R. 28.)

Schemes and artifices.

The schemes and artifices through which the said persons were to be defrauded, generally stated, were described as follows:

1. That they should and did, on or about March 5, 1924, organize and cause to be organized the Italo-American Petroleum Corporation and issued and sold, and caused to be sold, to some of the persons defrauded, its stock, at the par value of $1 per share.

2. That they should and did, on or about March 8, 1928 (R. 28), organize the Italo Petroleum Corporation of America, and should and did issue and cause to be issued and sold its preferred and common stock to such persons to be defrauded. (R. 28-9.)

3. That some of the defendants should and did dominate and control the activities and business of said two corporations. (R. 29.)

4. That they should and did, on or about May 16, 1928, loan to the Italo Petroleum Corporation of America $80,000, and that defendants, some of whom

were directors and officers of said Italo Petroleum Corporation of America, should and did wrongfully receive for their own use and benefit, as a bonus for the making of said loan, 80,000 shares of the capital stock of said corporation. (R. 29.)

5. That defendants, while controlling the activities of said Italo Petroleum Corporation of America and while some of them were its directors and officers, should and did cause said corporation to agree to purchase the assets of the Brownmoor Oil Company which agreement should and did provide that said Italo Petroleum Corporation of America should and did pay a consideration therefor in excess of the actual value of said assets, viz., 600,000 shares of common and 600,000 shares of preferred stock of said last named corporation as part of the purchase price, and that some of the defendants should and did unlawfully receive a part of said stock and some of the proceeds of the sale of said stock not giving any consideration therefor. (R. 29-30.)

6. That defendants should and did, on or about May 11, 1928, file with the Commissioner of Corporations of California an application for a permit to issue said 600,000 shares of common and 600,000 shares of preferred stock to said Italo Corporation as a part of the purchase price of said assets of said Brownmoor Oil Company, which permit was issued on May 16, 1928. (R. 30.)

7. That on or about June 1, 1928, defendants should and did issue and cause to be issued said stock to said Brownmoor Oil Company. (R. 31.)

8. That defendants should and did make application to said Commissioner of Corporations to distribute the stock of said Italo Corporation theretofore issued to said Brownmoor Oil Company to stockholders of said Brownmoor Oil Company and that they should and did, on or about June 19, 1928, receive a permit to distribute 575,000 shares of common and 575,000 shares of preferred stock to said stockholders. (R. 31-2.)

9. That said defendants agreed that they should and on or about June 1, 1928, they did, prior to the granting of said permit, distribute 600,000 shares of common and 600,000 shares of preferred stock so issued to said Brownmoor Oil Company as part of said purchase price, and that they should and did distribute some of said stock, to themselves and other persons for their use, they then and there not being stockholders of said corporation. (R. 32.)

10. That they should and did, on or about June 16, 1928, form a syndicate in which some of them became members who were officers and directors of said Italo Petroleum Corporation of America, and dominated its activities and caused said corporation to issue 6,000,000 shares of its stock for the benefit of said syndicate, which corporation should and did receive the sum of not to exceed $3,500,000 therefor, and they should receive profits as members of said syndicate which would be derived from the sale of said stock without the knowledge of the persons to be defrauded who were stockholders or about to become stockholders of said corporation. (R. 33.)

11. That some of the defendants, while dominating said Italo Petroleum Corporation of America and while officers and directors thereof, should and did, on or about July 5, 1928, cause said corporation to enter into an agreement with McKeon Drilling Company, Inc., by which the Italo Petroleum Corporation of America agreed to purchase certain assets of the McKeon Drilling Company, Inc., and pay a consideration far in excess of their actual value and as part consideration to issue and deliver to McKeon Drilling Company, Inc., 4,500,000 shares of its stock. (R. 34.)

12. That some of the defendants who were officers of said Italo Petroleum Corporation of America should and did have a secret arrangement whereby they should and did receive back from McKeon Drilling Company, 2,500,000 shares of said capital stock without the knowledge of the stockholders of said Italo Petroleum Corporation of America. (R. 34-5.)

13. The defendants should and did cause to be sold to some of the persons to be defrauded said stock so received by them under said secret agreement and converted the proceeds thereof to their own use. (R. 33.)

14. That some of the defendants should and did apply to the Commissioner of Corporations for a permit to issue the stock of said Italo Petroleum Corporation of America for the purpose of acquiring said assets of McKeon Drilling Company, and represented to said Commissioner that said Italo

Petroleum Corporation of America had entered into an agreement with McKeon Drilling Company to deliver to it 4,500,000 shares of its capital stock knowing that it should and did receive only 2,000,000 shares, thereby defrauding stockholders of said Italo Petroleum Corporation of America of 2,500,000 shares of its stock. (R. 35-6.)

15. That defendants agreed that they should and did, for the purpose of persuading persons to be defrauded to purchase stock of the Italo-American Petroleum Corporation, and to lead them to believe that the company was then operating at a profit, pay dividends on said stock which would not be paid out of the net earnings of said corporation, but out of capital. (R. 36-7.)

16. That said defendants should and did make the following representations:

(a) That McKeon Drilling Company was receiving 4,500,000 shares of stock of Italo Petroleum Corporation of America as consideration for said properties, when it was receiving only 2,000,000 shares. (R. 37.)

(b) That Italo Petroleum Corporation of America was properly and efficiently managed and had made profitable acquisitions, although they knew to the contrary. (R. 38.)

(c) That following the formation of the Italo Petroleum Corporation of America it at once undertook a sound development program (meaning that the program of said corporation in ac-

quiring its holdings and the contract entered into with McKeon Drilling Company was a sound program) when in fact it was not. (R. 38.)

(d) That what had become one of Italo Petroleum Corporation's most important and valuable assets was its recent acquisition of the world-famous "Trumble" petroleum refining patents, when it knew that such patents were never acquired and were never an asset. (R. 38-9.)

(e) That the securities of the Italo Petroleum Corporation of America had been established as one of the soundest investments, when it was not a sound investment. (R. 39.)

We have directed the court's attention at this point to the substance of the fifteenth count contained in the indictment in order that it may appreciate the argument which follows, directed not alone to the claim that the evidence is insufficient to justify the conviction of either of the two appellants, but as well to certain legal propositions to which reference will hereafter be made which in our judgment demand a reversal of the judgment of the court below.

As has probably already been observed, in the preparation of the indictment, various alleged activities of the defendants named in the indictment both contemplated and effected, are pleaded chronologically. In our presentation of the facts, as far as practicable, we will pursue an identical course principally in order that we may demonstrate to the court the utter absence of any connection between appel-

lants John McKeon and Robert McKeon and the alleged conspiracy, as well as the claimed activities of defendants, and, in those instances where the said appellants have participated in any of the transactions of which mention is made in the indictment to establish that such participation was neither sinister nor corrupt, but on the contrary, honest, within the law and intended for the best interests of Italo Petroleum Corporation and its stockholders.

FOREWORD.

The principal charge made against the appellants John McKeon and Robert McKeon is that they participated in a conspiracy having for its purpose, among other things, the sale of certain assets of the McKeon Drilling Company for a consideration far in excess of their actual value, and as part thereof to cause the purchaser, Italo Petroleum Corporation of America, to issue to it 4,500,000 shares of its capital stock; that as a result of a secret agreement, certain of the defendants who were officers or in control of Italo should receive back from the McKeon Company 2,500,000 shares of said stock without consideration; and that by said agreement said defendants intended to and did convert the proceeds derived from the sale of said stock to their own use and benefit, to the exclusion of the use and benefit of said Italo and its stockholders.

It is claimed by these appellants that not only was the evidence legally inadequate to warrant their conviction upon the charges made against them, but on

the contrary the evidence WITHOUT CONTRADICTION demonstrated that the value of the assets of the McKeon Company sold to the Italo exceeded the consideration paid therefor and that when, due to the depression and oil curtailment as well as other causes over which none of the defendants had any control, the Italo Company was confronted with financial disaster, not only was substantially all of this stock, or its proceeds, utilized for the benefit of Italo to avoid such disaster, but the private fortune of John McKeon as well.

We believe that an examination of the evidence in this case cannot help but convince this court that the conviction of these appellants was legally unjustified, and that for this reason alone the judgment of the court below must be reversed.

In attempting to establish the charges set forth in the indictment the government offered but meager oral evidence, relying almost exclusively upon documentary proof. In contending that it had made out a prima facie case of conspiracy it relied mainly on inferences which it claimed the jury was justified in drawing from this documentary evidence, much of which was complicated and involved.

In our opinion it would be humanly impossible for this court to acquire any substantial knowledge of the case itself from an examination of the evidence introduced on behalf of the government alone in the absence of an intensive study of most of the exhibits introduced involving painstaking and arduous labor on its part, and that no proper understanding of these exhibits could be had without giving consideration to

the evidence introduced by defendants in their explanation and to overcome any adverse inferences that in the absence of such explanation might be indulged therefrom.

To lessen the labors of the court we intend, at the risk of prolixity, to present in sequence the facts relating to the transactions which are the subject-matter of this indictment. Such statement will assist the court in understanding the controversy and more readily reaching a conclusion with respect to the legal propositions, which will be presented for its determination. While the statement, at first glance, may appear to be unduly elaborate, it is intended to be utilized by the remaining appellants and thus the briefs filed in their behalf will be substantially shortened.

It is claimed by appellants that among others reversible error was committed by the trial court in proceeding with the trial in the face of an affidavit of prejudice; in admitting into evidence books and records in the absence of an adequate foundation for their introduction; in admitting into evidence books and records of concerns with which appellants had no connection, over which they had no control and respecting which they had neither information nor knowledge; in admitting into evidence tabulated summaries and testimony relating thereto, legally inadmissible and highly prejudicial, and in sending into the jury room for consideration by the jury during its deliberations evidence which had previously been excluded by the court. These errors can be considered and passed upon by this court without engaging in the labor of reviewing the evidence, or making a study of the entire record.

STATEMENT OF FACTS.

Antecedents of appellants and their previous knowledge of and association with Wilkes.

The defendant, A. G. Wilkes, came to California in 1902, where in 1908 he entered into what is generally known as the oil business. Between 1908 and 1920 he organized and became interested in various companies engaged in the business of acquiring potential oil lands and producing oil. He organized the May Oil Company, The California Amalgamated Oil Company, the Head Drilling Company, the United Western Oil Company and several other large concerns. In association with Eastern capitalists the properties of some of these concerns were consolidated into a company known as the Western Union Oil Company, which was subsequently absorbed by the Union Oil Company of Delaware, a company also organized by Wilkes. This latter company is today known as the Shell Union Oil Company of California. On behalf of the Union Oil Company of Delaware Wilkes raised approximately fifty million dollars which was utilized in acquiring oil properties in California, including the assets of the Columbia Oil Company, a very substantial concern, and about 30% of the stock of the Union Oil Company of California. (R. 1200-2.)

Wilkes had been born and reared in the same town from which the appellants, John McKeon and Robert McKeon, had come. Robert McKeon had known him

practically all his life and John McKeon had been acquainted with him for many years. (R. 1110.)

Appellants Robert McKeon and John McKeon are two of four brothers, who, as it will later appear, became the owners of the McKeon Drilling Company, the assets of which were subsequently acquired by the Italo Petroleum Corporation of America. John McKeon started in the oil business as a laborer in 1911, being then employed in the Taft Midway Field at the instance of the defendant Wilkes. From that time until 1918 he worked for the various companies above mentioned in various capacities which included laborer, tool dresser, driller, foreman and superintendent, being finally placed in charge of operations of the different companies. (R. 1200.) During this period his relations with Wilkes became very intimate. He worked directly under and with him, having at all times confidence in his integrity and ability. (R. 1202.) When in about 1918 the Commonwealth Company, which was subsequently changed into the Union Oil Company of Delaware was organized, in recognition of his services Wilkes gave John McKeon a substantial block of its stock. In 1920 when John McKeon left the employ of Wilkes he sold this stock for $65,000 which with $20,000 credit accorded him by the Union Tool Company enabled him to start in the contracting business for himself. (R. 1202.)

Appellant Robert McKeon likewise has been employed in every phase of the oil business, his testimony being:

> "I have worked at practically every line of work in the oil fields from driving a team up to production superintendent. In connection with my work in the oil business I attempted to learn all that I could about the business and give it my close attention and thought for a good many years. I have been connected with the actual drilling of in excess of one thousand wells in California alone." (R. 1111.)

From 1917 to the spring of 1920 he was employed by the Head Drilling Company owned by Wilkes and Head, drilling wells in Wyoming. (R. 1111.) When his brother John, early in 1920, engaged in business for himself, Robert McKeon came to California and entered his employ. (R. 1111.)

McKeon Drilling Company.

In late 1923 John McKeon organized the McKeon Drilling Company, Inc. to which he transferred his business. (R. 1112; 1202.) During the three years that he had been engaged in business he had been very successful and his assets were then of the value of approximately $2,000,000. (R. 1202.) Upon the incorporation being effected, John McKeon gave 30% of the stock to his brother, Robert McKeon, 30% to his brother Raleigh, 10% to another brother Paul and retained 30% for himself. (R. 1112; 1202-3.) With respect to this transfer Robert McKeon testified:

> "We had been working together all of our lives and John decided it would be a fair thing to incorporate the business, which up to that time he

had owned, and to allow us all to share in it with him. He gave us our interest in the company." (R. 1112.)

Although the McKeon Drilling Company, Inc. continued in the contracting business, it gradually engaged in the production of oil, acquiring a number of leases upon which it developed wells, increasing its oil production until it had built up an extensive business from which it made substantial profits. (R. 1112.)

In 1926 the McKeons organized the McKeon Oil Company, owned one-half by themselves and the other half by the Richfield Oil Company. After developing a number of wells, in 1926 their interest was sold to the Richfield Oil Company, whereupon John and Paul McKeon entered the employ of the Richfield Oil Company, the former in charge of its production department at an annual salary of approximately $100,000, and the latter taking charge of its field operations. (R. 1113.) Robert McKeon and Raleigh remained with and continued to operate the McKeon Drilling Company. (R. 1113.) Shortly thereafter the McKeon Drilling Company sold all of its properties excepting an oil well located on Signal Hill known as the Crown City Oil Well (R. 1113), and immediately started to acquire new leases, covering oil properties which it undertook to develop by drilling wells. By the early part of 1928, as a result of its activities the McKeon Drilling Company had re-established itself in the business of producing oil on a substantial basis. It possessed a number of valuable leaseholds, covering

proven oil territory upon which it had a number of producing wells that were yielding substantial profits; it was drilling more wells and it had assembled a very complete drilling outfit. (R. 1113.)

With respect to the character and value of its properties, and the net income which it was enjoying from its business reference will later be made. Before touching these subjects and in order that the court may understand the circumstances preceding and surrounding the sale of the assets of the McKeon Drilling Company to the Italo Petroleum Corporation of America, it is necessary to draw its attention to other phases of this controversy with which, however, neither of these appellants had anything whatever to do, and with which they are not connected in the slightest degree. Notwithstanding this situation, which cannot be successfully challenged, a mass of evidence relating to these phases of the controversy was admitted as against them, over their objection, a consideration of which by the jury undoubtedly assisted in persuading it to return the verdict of which complaint is made by these appellants.

Italo American Petroleum Corporation and its activities.

On March 5, 1924, the Italo-American Petroleum Corporation was incorporated under the laws of California, having a capital of $1,000,000 divided into 1,000,000 shares of the par value of $1.00 per share. It was incorporated for the purpose of producing and marketing petroleum products and otherwise engaging in the general oil produc-

ing, refining and marketing business. (R. 190-1.) It is conceded that none of the defendants against whom the indictment was returned appeared as an incorporator. (R. 191.)

During 1926 and 1927 the defendants, John M. Perata, Paul Masoni and F. T. Tommasini were directors and officers of this corporation, being president, vice-president and secretary respectively. (R. 193.) It was obvious that during this period the company was to some extent financially embarrassed because it appears that Perata and Masoni were required to advance to it some $15,000 or $20,000 to take care of its current obligations. (R. 196.) Prior to September, 1926, the company had disposed of all of its capital stock excepting 253,150 shares for the sale of which a permit had been obtained from the Corporation Commissioner. On September 23, 1926, an agreement was entered into between the corporation and Frederick Vincent & Co. in which the latter was given the exclusive right for a period of sixty days to sell shares of stock, its compensation being fixed at 20% of the selling price. (R. 370-1.) In connection with the sale of this stock literature was issued and mailed by the corporation itself as well as by Vincent & Co. (R. 372-5.) Between the date of the contract and March 1, 1928, Vincent & Co. sold all of the stock, the net proceeds of which were turned over to the corporation, excepting the sum of $49,360 which was still due when its assets were sold to the Italo Petroleum Corporation of America. (R. 418.)

The officers of the Italo-American Petroleum Corporation were without practical oil experience, upon which subject Perata testified:

> "Thereafter I was elected president of the company. I had never had any experience in the oil business up to that time. * * * At the time I became president of the Italo-American Petroleum Corporation there were no practical oil men in the organization." (R. 833.)

Italo-Amer. Co. enlists aid of Wilkes.

Perata endeavored to obtain the services of a practical oil man to manage the affairs of the corporation, and finally, upon the recommendation of Frederick Vincent and Mr. Spalding, the latter a Los Angeles attorney, Mr. Wilkes was employed. Before accepting employment, however, Wilkes made a thorough investigation of the company. (R. 834.) On November 20, 1927, Wilkes was elected a director and appointed vice-president and general manager of the company to serve without compensation or salary. (R. 193.) At the time Wilkes assumed the management of the company its assets consisted of an interest in three or four wells located at Long Beach and a 10-acre lease known as the Wiley-Tobin lease. (R. 834.) Immediately after his appointment he advised the directors that in order to become a successful oil company it was essential to have oil lands. He thereupon commenced negotiating to accumulate other properties, but due to lack of capital it was finally concluded that a reorganization was absolutely essential and should be effected (R. 834), whereupon on

the advice of its attorneys the organization known as Italo Petroleum Corporation of America was brought into existence. (R. 834-5.)

Organization of Italo Petroleum Corporation of America and purpose thereof.

Due to the lack of capital on the part of the Italo American Petroleum Corporation to acquire oil-bearing properties or to pursue production operations; as a result of conferences and discussions between officers of the corporation and Stratton (an official of Vincent & Co.) and others it was concluded to bring into existence a corporation the capital structure of which would be sufficient to enable it, through the sale of stock, not only to acquire the assets of the Italo-American Petroleum Corporation but also a group of proven and potential oil properties the development of which would enable the corporation to make a substantial return upon its investment and permit the payment of dividends to its stockholders.

With this object in view Wilkes was authorized to pursue investigations for the purpose of locating and acquiring such properties, it being the intention, if possible, to purchase the properties selected either for cash (to be raised from the sale of stock) or for stock, or for cash and stock. (R. 236, 240-4.) Accordingly on March 8, 1928, the Italo Petroleum Corporation of America was organized under the laws of the State of Delaware having a capitalization of $25,000,000 divided into 16,000,000 shares of common and 9,000,000

shares of preferred stock of the par value of $1.00. (R. 208.)

Upon the formation of the company the incorporators, who were also directors, at a meeting held in Delaware, elected in their place as directors John M. Perata, Paul Masoni, F. V. Gordon, Robert McKeon and A. G. Wilkes. Thereafter and on March 14, 1928, a directors' meeting was held in San Francisco, whereupon Perata was elected president, Masoni secretary-treasurer and Wilkes vice-president. (R. 236-7.)

Notwithstanding the fact that Robert McKeon, at the instances of Wilkes, had agreed to become a director of the new corporation, he never qualified as such and never attended a directors' meeting until July 6, 1928, long after the organization of the company and long after the purchase of the properties of Italo-American Petroleum Corporation had been consummated, until which meeting he knew nothing whatever about the company or any of its affairs or activities. (R. 1120.) In stating the circumstances under which he became a director, Robert McKeon testified:

> "I first acquired information or knowledge concerning Italo Petroleum Corporation of America in the spring of 1928. Mr. Wilkes called on me one day and said that he had re-entered the oil business and was employed by the Italo American Company to see what he could do with the company. He said that the company had been started by a group of San Francisco Italians who knew nothing of the oil business but that they had in his opinion some good assets on the

> Hill and that they had employed him to put the company on its feet and do whatever was necessary to rehabilitate it; that he was going to reorganize a new company to handle some properties and raise some additional money, and that he would like to have a few practical oil men on the board with him, and asked me if I would serve as a director on the board. I said I would. That was my first introduction to and knowledge of the Italo Petroleum Corporation. That conversation with Wilkes was in February or March, 1928." (R. 1118-19.)

With respect to the properties of the Italo-American Petroleum Corporation, during the same conversation Wilkes informed McKeon that it had a ten-year lease known as the Wiley-Tobin lease with which McKeon was acquainted; that he had entered into an agreement with the Continental Oil Company to drill some deep wells on that property on a 50/50 basis; and that they had a refining and dehydrating plant and had the hill well covered with pipe lines. Wilkes further informed him that he was going to reorganize to take over the assets of the old company and, after asking McKeon's opinion respecting the chance of deep sand production on the Wiley-Tobin lease, Wilkes said that:

> "The Italo Company had entered into the distribution of gasoline and motor oils and it made a contract with the California Petroleum Corporation for refining gasoline and oil and would open service stations in various parts of Northern California. And he told me about their increased sales from month to month and thought

that would be a very profitable branch of the business, distributing gasoline at first and then possibly at a later date refining it, that is to have a market established for their products." (R. 1120.)

With respect to the directors of the new company, Wilkes further said:

"that Fred Gordon was going to resign as vice-president of the California Petroleum Corporation and come with him in the new company and that some of the old San Francisco men from the old company would also be on the board." (R. 1120.)

This was the first conversation that had occurred between Robert McKeon and Wilkes within a period of two or three years. (R. 1210.)

That John McKeon likewise had nothing whatever to do with the organization of the new company is shown by his uncontradicted testimony:

"with respect to the charge in the indictment that I had some connection with and did organize or aid in the organization of the Italo Corporation of America, I had nothing to do with that at all. I was not familiar with the details of it. I did not give any directions as to how it should be organized." (R. 1226.)

No participation by McKeons in the acquisition of assets of Italo-American Petroleum Corporation.

Prior to March 14, 1928, the Italo-American Petroleum Corporation, by resolution, had offered to sell

to the new corporation its business, property and assets subject to liabilities not exceeding $81,742.48 in consideration of the issuance to it of 500,000 shares of preferred and 1,000,000 shares of common capital stock of Italo Petroleum Corporation of America. (R. 237.) This was given consideration by the directors of the new corporation, at a meeting held on March 14th, 1928, and a resolution adopted accepting such offer (R. 236-7), pursuant to which an agreement was subsequently entered into between the two companies. (R. 267; 271-2.) A resolution was then passed authorizing Wilkes to file with the Commissioner of Corporations an application for a permit approving the purchase of the assets of the Italo-American Petroleum Corporation and also for permission to issue and sell 300,000 units of stock for a price of $1.50 per unit, subject to a selling commission of not to exceed 20%. (R. 237.)

Shortly thereafter, the requested permits were issued and the purchase of the Italo-American Petroleum Corporation assets consummated. This was several months before the date upon which for the first time Robert McKeon ever participated in the affairs of the Italo Petroleum Corporation of America. (R. 1120.)

We have already directed the court's attention to the conversation occurring between Wilkes and Robert McKeon during February, 1928, respecting the intention on the part of Italo Petroleum Corporation to acquire the assets of Italo-American Petroleum Corporation. The record without dispute affirmatively

discloses that Robert McKeon had nothing whatever to do with the acquisition of these properties. Upon this subject he testified:

> "I know nothing whatever about the Italo-American Petroleum Corporation or its being taken over by the Italo Petroleum Corporation except what Mr. Wilkes told me, as I have heretofore testified. I had nothing whatever to do in the organizing of either of these two companies. I know nothing whatever of * * * the taking over of the Italo-American properties by which anybody was to be defrauded or cheated, or anything about them that was unfair." (R. 1123-4.)

That John McKeon did not participate in this transaction is clearly shown by his testimony, which is as follows:

> "And although I am accused in the indictment of having participated in the incorporation of a company known as the Italo-American Petroleum Company in 1924, that accusation is not true. I never heard of that company until late in 1927, at which time Mr. Wilkes came to me and told me he was contemplating making a connection with that company. He told me he expected to go into that company and develop it if possible, and showed me a list of the assets and wanted my opinion on what the values were. I gave that the best I could. The next I heard of the company was in the spring of 1928. I did not become connected with the Italo-American Petroleum Company at all. I never had any connection with it either as a stockholder, director, officer or creditor." (R. 1203.)

"I had no connection with the turning over of the actual properties belonging to the Italo-American Corporation to the Italo Corporation of America or the issuance of the stock. The only transaction I ever had with Italo was putting my own properties in. Prior to that I had no relationship with the company at all. * * *" (R. 1226.)

Brownmoor Oil Co. and $80,000 syndicate deal.

Brownmoor Oil Company was a corporation having issued and outstanding 1,000,000 shares of stock. In late 1927 and early 1928 its assets consisted principally of a refinery at Long Beach, a property known as the Brown lease in Inglewood, Los Angeles County, California, and certain property located on the Kern River Front. At this time they were drilling a well on the Brown lease. (R. 694.) Upon its Kern River Front property, which consisted of 600 acres and was also known as the Cauley lease (R. 702) it had three producing wells, and three additional wells were about completed. (R. 694.) The completed wells were producing in the neighborhood of 250 or 300 barrels per day. (R. 694.) Upon making inquiry of an official of the Standard Oil Company, which owned the surrounding property, Wilkes was advised that the Kern River Front property was very valuable. (R. 695.) The surrounding territory, upon which producing wells were located, was owned by a number of major oil companies. (R. 702.) Wells could be drilled on this property in three weeks' time and without much expense, and it ap-

peared to Wilkes that the purchase of this property would build up the Italo production to 5000 or 6000 barrels a day without great difficulty. (R. 703.) As a result of his own judgment, based upon his 20 years' experience in purchasing oil properties, and as a result of conferences with Dr. Starke, formerly Chief Geologist for the Standard Oil Company, and Dr. Thompson, head geologist for Richfield Oil Company, both of whom had made reports upon the Kern River Front tract, and upon the opinions of several other engineers including the engineer for the Petroleum Securities Company (which was in possession of adjoining property) Wilkes concluded that it was splendid oil property. (R. 703-4.)

On its Inglewood property the company owed $100,000 to the Monrovia Company, from which it had been purchased, which obligation was secured by 250,000 shares of Brownmoor stock. Upon this property Wilkes obtained an adverse report. (R. 695.)

Negotiations for sale of Brownmoor.

The defendant Siens then was and prior thereto had been president of Brownmoor Oil Company. That company was desirous of selling its assets, which resulted in negotiations between Siens and Wilkes, the latter representing the Italo Corporation. Wilkes finally informed Siens that he would be interested in making a deal on the refinery property and the Kern River Front property, but would not be interested in taking over the Brown lease at Inglewood, unless they could get rid of the $100,000 obligation. A day or two

later Siens informed Wilkes that he believed he could get rid of the Inglewood lease and wanted to know if Wilkes thought that Vincent and Company would be interested in purchasing the stock held by Monrovia Oil Company, through which purchase the $100,000 obligation could be paid. (R. 695-6.) Vincent agreed to make such purchase provided he was informed that the Italo Corporation intended to go ahead with the Brownmoor purchase. (R. 696.) Subsequently Vincent informed Wilkes that he intended to purchase two other blocks of Brownmoor stock, one consisting of 100,000 shares and the other 200,000 shares, but he did not wish to become involved in such purchase unless the proposed deal was to be consummated. (R. 696.)

Vincent & Co. purchase Brownmoor stock.

As the result of further negotiations, it was finally agreed that the Italo Corporation should purchase the property of the Brownmoor Company, other than the so-called Brown lease, for a consideration of 1,200,000 shares (600,000 units), of Italo stock. (R. 697.) At this time Vincent & Company had an option on 550,000 shares of Brownmoor stock above mentioned, which it finally purchased. (R. 697.) The 250,000 shares were acquired from E. M. Brown to whom the Monrovia Oil Company had assigned the promissory notes aggregating $100,000 together with the certificates representing the stock. The transaction was evidenced by an assignment of these notes and certificates executed by Brown. (R. 394-5.)

In addition to the options just mentioned an agreement dated May 31, 1928, was entered into between Vincent & Company and Siens, Westbrook and Shores in which Vincent & Company agreed to purchase 240,000 units of Italo stock, which would be exchanged for their Brownmoor stock upon the purchase by Italo of the assets of the Brownmoor Oil Company. (R. 391.) Vincent & Company therefore had options to purchase 950,000 shares of Brownmoor Oil stock.

As showing that no one had any interest in the optioned Brownmoor stock excepting Vincent & Company, George Stratton, a member of that firm and a witness for the government, testified:

> "Neither Masoni nor Perata were ever interested with us in buying options on the purchase of any of the Brownmoor stock and we never had any understanding with them directly or through Wilkes. We did not have any understanding through Mr. Wilkes that Perata and Masoni were to furnish a part of the money to buy the Brownmoor shares. Nobody had any interest in it except ourselves." (R. 421.)

$30,000 loan to Italo.

Up to this time Vincent and Company had not been able to make much progress in the sale of the 300,000 units of Italo Petroleum Corporation stock for which they had subscribed, and the Italo Petroleum Corporation was in need of funds. (R. 706.) It was then suggested by Vincent that if the Brownmoor property was purchased he would have no difficulty in raising funds. (R. 706.) Wilkes informed him, however, that

he would not sign the Brownmoor contract unless he was certain of raising at least $80,000 to $100,000, which was needed to carry on the work then in progress on the Brownmoor property. (R. 706.) Wilkes then suggested that they go over and see the defendant, Fred Shingle, and ascertain whether they could not interest him in becoming interested in the company to the extent of helping finance its operations. (R. 707.) As the result of conferences with Shingle, and later Shingle and Brown (R. 707), and after an investigation of the Italo and Brownmoor properties had been made by them, they stated that they would loan the Italo Petroleum Corporation $80,000, but wanted to know what consideration they would receive for such loan. (R. 708.) Vincent at that time, having options on the Brownmoor stock and realizing that if the assets of that company were purchased by the Italo Petroleum Corporation, the stock of the latter company would increase in value and could be readily sold, agreed to deliver Shingle as a bonus for making the loan 80,000 shares of Brownmoor stock which he then had under option. (R. 708.) At that time both Vincent and Wilkes informed Shingle that if the loan was procured and the Brownmoor property purchased, the Italo stock to be received by the Brownmoor Company for its assets would eventually be exchanged for the outstanding shares of Brownmoor. (R. 708.)

Vincent gives 80,000 shares Brownmoor for loan.

At the time the loan was agreed to Vincent not only informed Shingle that the 80,000 shares of Brownmoor stock would be delivered as a bonus (R. 885; 708-9), but that he had options on some of the Brownmoor stock, from which he expected to make a profit, and that if such profit was made he would give a part of it to Shingle, Brown & Co. (R. 708-9; 885.) Thereupon a syndicate agreement was prepared providing for the loan of $80,000 to the Italo Petroleum Corporation (U. S. Ex. 238) repayable in 3, 6, 9 and 12 months at 7% interest, secured by an assignment of certain leases including the producing leases on Signal Hill and the dehydrating plant. (R. 887.)

$80,000 syndicate subscriptions.

Acting upon the recommendation of Shingle, Brown & Co. a number of their friends became subscribers to the syndicate. No subscriptions were solicited from anybody connected with the Italo Petroleum Corporation or the Brownmoor Oil Company. (R. 887.) Several days after the subscriptions were started Wilkes inquired whether some of their friends or associates could join the syndicate. Upon being advised in the affirmative a few of their friends, some of whom were connected with the Italo Petroleum Corporation, became subscribers. Jones and Mikel, members of the firm of Shingle, Brown & Co. had each subscribed $2500. Perata, however, wanted to subscribe $5000 but inasmuch as the entire amount of the loan had been subscribed, as a matter of accommodation Jones

and Mikel each assigned their subscriptions to Mr. Perata who paid for them with his check for $5000 dated May 14, 1928, represented by U. S. Ex. 316. (R. 888.) This accounts for the notation which appears on the side of Ex. 142 "Paid Perata". Brown, who had subscribed $2500, assigned his subscription to Mrs. O. B. Wilkes, which accounts for the notation on U. S. Ex. 142 "Paid O. B. Wilkes". (R. 651.)

A few days after Wilkes was advised that the $80,000 loan would be made, it became necessary for the Italo Petroleum Corporation to borrow $10,000 to close the deal on an oil lease near Santa Maria which it was endeavoring to acquire. The loan of this sum was made by Vincent and Shingle, each contributing $5000. (R. 888-9.) Shingle insisted that some security be given for the $10,000 loan, whereupon Vincent sent to him a certificate for 80,000 shares of Brownmoor Oil Company upon the understanding that it should first act as security for the $10,000 loan, and upon its payment should be retained by Shingle on behalf of the syndicate as the bonus which Vincent had agreed to give for making the $80,000 loan. (R. 743-4; 888.) That this 80,000 shares of Brownmoor stock came from Vincent and not from the Italo Petroleum Corporation is shown by the testimony of Shingle, wherein he states:

> "The 80,000 shares did not come from the Italo Petroleum Corporation, but came from Vincent." (R. 889.)

This situation is also attested by Government's accountant Goshorn, who testified:

"Italo Petroleum Corporation of America never put up the 80,000 shares of Brownmoor Oil Company stock that became the bonus stock for the $80,000 loan syndicate agreement." (R. 651.)

McKeons not involved in syndicate loan.

With respect to this $80,000 syndicate and the loan of the $80,000 to the Italo Corporation the McKeons had nothing whatever to do. According to John McKeon:

"I had no relation to the $80,000 syndicate and received no part of the consideration that was paid to the syndicate members and knew nothing whatever about it. * * * My brothers had nothing to do with those transactions either." (R. 1226.)

While there is some conflict unimportant in character between the testimony of Shingle and Stratton with respect to the source of the 80,000 shares of bonus Brownmoor stock, all of the witnesses were in accord that none of the McKeons had any connection direct or indirect with the $80,000 loan. George Stratton, while testifying for the government, said:

"All of my negotiations either with respect to the Brownmoor transaction, the $80,000 loan or the big syndicate, where they took over all of the properties, and subsequently, were with Mr. Wilkes and with nobody else. I don't think I talked with any of the defendants about the big syndicate except Mr. Wilkes." (R. 433.)

This evidence was corroborated by Wilkes, who testified:

> "In the discussions that were had between Vincent, Shingle, Brown and myself, Vincent stated to Shingle and Brown that he (Vincent) would arrange for and secure the putting up of the 80,000 shares of Brownmoor stock. He told them that he was working with the Brownmoor stockholders and it was to his interest to obtain the $80,000 loan for the Italo Petroleum Corporation so that the options that he had on the Brownmoor stock would become of some value. * * *" (R. 744.)

And emphasizing the fact that the McKeons had nothing whatever to do with the Brownmoor deal, he further testified:

> "None of the McKeon brothers had anything to do with the Brownmoor deal." (R. 257.)

With the announcement of the Brownmoor deal the situation changed overnight. Vincent was able to sell a very large amount of stock and shortly thereafter the Italo Petroleum Corporation was able to pay back the $80,000 loan from Shingle. (R. 710.)

Acquisition of properties of McKeon Drilling Company.

We have already shown that Wilkes was authorized to make such investigations as were deemed essential for the purpose of enabling the new corporation, Italo Petroleum Corporation of America, to acquire known or potential oil bearing properties and thus enable it to engage actively and intensively in

the business of oil production and sale. He had already negotiated for the purchase of a number of properties deemed by him, as well as by experienced geologists with whom he had advised, to be properties of merit and value. It was the intention of the company to group together and purchase these available properties contemporaneously in order that those to whom it intended to offer stock in payment or part payment for these properties would appreciate the added value that their acquisition would give to the stock and also the return which could reasonably be expected from the operation of these properties.

John McKeon urged to sell McKeon properties to Italo.

After having concluded negotiations respecting several of these properties, and having agreed upon their purchase price, Wilkes proposed to John McKeon that the properties and business of McKeon Drilling Company be made a part of the consolidation. Upon this subject John McKeon testified:

> "Mr. Wilkes explained to me when he finally came to me to make a proposition to get our properties to go into the consolidation, he showed me a list of the properties he had been figuring on and expected to put together and wanted our properties to go in with that group of properties, and I told him, the day he called on me, that I felt his plan was too ambitious. I did not think it would be possible for him to raise the necessary finances to put the properties together, and rather discouraged him on it; but he assured me that he was sure he could do that, and in a

> day or so later he brought Mr. Vincent back to my office with him, he being the fiscal agent of the company, and Vincent assured me that if he could have a company with the basis of the properties that they were contemplating and properly managed, that he would have no trouble in raising any amount of money." (R. 1204.)

Vincent then called his attention to the fact that he had recently raised $300,000 or $400,000 in a week or ten days, and when Wilkes stated that he intended to go to New York and expected to get part of the money there from some of the people with whom he had formerly done business McKeon

> "felt that they could finance their operations." (R. 1204.)

Because of their long experience in and familiarity with the oil business, both John and Robert McKeon were fairly familiar with all oil properties in California including the properties proposed to be put into the merger. (R. 1204-5.) The fact is that all major companies, through their scout and geological departments, kept in touch with all oil properties in California as well as their ownership and disposition. This is made manifest by the testimony of John McKeon, who said:

> "The Richfield had been acquiring a lot of properties and we had our scout and geological department who kept us advised on every property in the state. In fact, we had properties in every field and knew the condition of pretty nearly everybody's properties. All large companies do that." (R. 1205.)

McKeon Drilling Co. production and income.

The properties intended to be and which were subsequently put into the consolidation, according to John McKeon, constituted a sound oil operation then having between 13,000 and 15,000 barrels per day production, together with a lot of undeveloped land possessing splendid potential value. In fact, John McKeon believed that the project was the best Wilkes had ever started. (R. 1205.) That it would have been a success excepting for the conditions and circumstances not then anticipated is shown by John McKeon, who stated:

> "I had seen him all these years start on projects and each one of them had worked out to an ultimate success; in fact, to a very good success in three different instances; so I had no reason to believe but that this would be a success, and it would have been a success had not the conditions prevailed that have prevailed in the meantime. Every condition and every circumstance that could arise and interfere with it did arise. The Italo properties today are still a sound basis and worth the full capitalization at which they were capitalized, their intrinsic value." (R. 1205.)

The desire of Wilkes to have the McKeon Drilling Company properties merged with the other properties, the purchase of which had already been negotiated, was communicated by John McKeon to his brother Robert, which communication was followed by a visit from Wilkes who discussed the proposal

with him. (R. 1124.) At this time the Graham-Loftus properties, to which reference will hereafter be made, were not included in the proposed consolidation. The proposition, however, did not appeal to Robert McKeon, his testimony being:

> "We talked nearly all afternoon about the advisability of our joining the merger. I myself did not feel so very keen about it. I felt that we had a very nice company; my brothers and I owned it all; we worked in harmony and had an income of around $100,000 a month. We had a number of what we considered good properties and with wells in various stages of drilling. We had a complete drilling unit. We had crews of what I believe, the best oil field workers in the country, men that worked for us ten to fifteen years, and I liked the business that we had. We were not interested in the refining of oil or the distribution of gasoline. That end of the business did not appeal to me at all, as I considered the sale of crude oil a nicer business. It was no trouble to sell the oil you could produce. There was no worry about getting your money. The day it was due it was on your desk." (R. 1124-5.)

At the conclusion of the conference Robert McKeon informed Wilkes that notwithstanding his reluctance to go further with the matter, nevertheless before reaching a definite conclusion he would confer again with his brothers, Raleigh and Jack. (R. 1125.) Either that night, which was fixed by Robert McKeon as in the latter part of May, 1928 (R. 1125), or within a few days thereafter, fixed by John Mc-

Keon as being near the first of June, 1928 (R. 1205), a further conference was held between Wilkes and Robert, John and Raleigh McKeon which was confined to whether it would be advisable to enter such merger. (R. 1125.) The reason for the reluctance of the McKeons to turn their properties into the merger is clearly pointed out by John McKeon, who testified:

> "We were in a very good position at that time and we had a very splendid income and unlimited credit, and we were a going concern, probably making us net above the cost, better than $1.000,000 a year, and our then present opportunities were better than they had been in a long time. So it was pretty hard for us to decide on changing that and going into something more or less speculative." (R. 1205-6.)

After Wilkes left, the three brothers continued to discuss the matter and it was finally agreed that Robert McKeon should negotiate further with Wilkes and likewise make a thorough investigation of all properties that it was proposed should go into the merger, and if he finally concluded that the proposal was worth while they would give the matter further consideration. (R. 1125; 1206-7.)

None of these subsequent negotiations were participated in by John McKeon, who was occupied in his employment with Richfield Oil Company, but he was kept constantly in touch with their progress by his brother Robert. (R. 1206; 1237.)

In a later conversation between Wilkes and Robert McKeon the latter informed the former that if he would come back with a definite outline of his plan he would be told whether the McKeons would or would not be interested in joining the proposed merger. (R. 1126.)

Up to this time the McKeons were under the impression that the properties to be included in the merger were going in with little or no indebtedness and it was upon that basis that Robert was authorized to proceed further with the negotiations. (R. 1206.)

Several days later Wilkes returned with a list of the properties proposed to be merged and informed Robert McKeon that the plan proposed by the Italo Petroleum Corporation was that a syndicate was to be formed that would underwrite 10,000,000 shares of stock and that it would purchase the properties under consideration and turn them over to the Italo Petroleum Corporation for the 10,000,000 shares of stock thus to be underwritten. (R. 1126.)

Proposal of McKeon Drilling Co.

In the meantime Robert McKeon had had his organization make up detailed reports, upon all wells in production upon the properties, as well as gather considerable information respecting the condition of the properties and their prospects. (R. 1126.) Finally Robert McKeon informed Wilkes that if a satisfactory deal could be worked out they would probably go into the merger upon the basis of $1,500,000 in cash and a stock interest in the company. (R. 1126.)

Included in this $1,500,000 cash was $500,000 required to pay off all of the existing liabilities of McKeon Drilling Company, so that if the deal were consummated it could turn its properties and business over free and clear of any indebtedness. (R. 1127.)

Wilkes then went to San Francisco and later returned to Los Angeles at which time he suggested as a counter proposal that in lieu of paying to McKeon Drilling Company $1,500,000 in cash the Italo Petroleum Corporation would assume the liabilities of the McKeon Drilling Company (amounting to $500,000), would pay to it $500,000 in cash and give notes for the remaining $500,000 payable in installments. (R. 1127.) After some discussion it was finally agreed that $1,500,000 should be paid in that fashion; that is, $500,000 down, $500,000 in installments, the new company would assume liabilities to the extent of $500,000 and give to McKeon Drilling Company 3,500,000 shares of stock. (R. 1127.) This agreement was reached upon the assumption that the group of properties was to be acquired for 10,000,000 shares of stock and that the only indebtedness of the new company would be the $500,000 they would owe the McKeon Drilling Company and the $500,000 of assumed indebtedness. (R. 1128.)

Program of Italo changed.

Pending the preparation of a contract to effectuate this deal, the Italo Petroleum Corporation eliminated the "Edwards property" which it had intended to

purchase and substituted therefor the Graham-Loftus properties which it had finally agreed to purchase for $3,000,000, $1,000,000 of which was to be paid upon the consummation of the transaction and the balance in installments. (R. 1128.) It had further agreed to transfer to a syndicate 6,000,000 units of stock for which the syndicate was to pay $3,500,000. Out of this sum $1,000,000 was to be paid on the Graham-Loftus property and $500,000 to the McKeon Drilling Company, and the balance was to be used in meeting the cash requirements connected with the purchase of the other properties. Assuming that the merger went through upon this basis, after the down payments the corporation would owe $2,000,000 to the Graham-Loftus Company and $500,000 to the McKeon Drilling Company which, with its other indebtedness, would aggregate approximately $2,750,000. Inasmuch as this indebtedness would have to be liquidated within a year, the payments would run between $225,000 and $250,000 a month, and instead of 10,000,000 shares of stock being issued as originally contemplated the proposition was that 12,000,000 shares would be issued. (R. 1129.) Under this plan the company would start out largely in debt with a larger stock issue than previously intended and with some changes with respect to the properties to be acquired. (R. 1129.)

Terms of sale agreed upon.

This alteration of the proposed set-up at first persuaded Robert McKeon not to go into the merger on the conditions proposed (R. 1129), principally because under the original proposal the only indebted-

ness of the Italo Corporation would be the unpaid amount due to the McKeon Company, while under the plan as changed its outstanding financial obligations would be very considerable. (R. 1130.) After reaching this determination, however, he engaged in further discussions with Wilkes and upon giving consideration to the value and then condition of the properties to be merged and reviewing the development work, both contemplated and proposed, he agreed to go into the merger for the cash consideration outlined, viz., $500,000 down, $500,000 in installments; the Italo Petroleum Corporation to assume the outstanding obligations of McKeon Drilling Company not exceeding $500,000 and to deliver to the latter company 4,500,000 shares of stock instead of 3,500,000 shares originally proposed. (R. 1129-30.)

It was this understanding that was embraced in the contract of July 5, 1928. (R. 1130.) The agreement is identified as U. S. Exhibit 44 and its substance is set forth on pages 305 and 306 of the record. This agreement is quite elaborate and has attached to it a number of exhibits describing the properties agreed to be sold by the McKeon Company to the Italo Corporation. It provided for the assumption by Italo Corporation of not to exceed $500,000 in liabilities to be paid within six months or a release to be delivered to the McKeon Company; the payment of $500,000 cash on or before August 1, 1928; the delivery to the McKeon Company of ten promissory notes by the Italo Corporation for $50,000 each due monthly beginning September 1, 1928, and the payment by the Italo Corporation to the McKeon Company of 4,500,-

000 shares of its capital stock of which not less than 2,000,000 was to be common stock, to be delivered within 60 days. The agreement provided that *it was subject to the provisions of the Corporate Securities Act and the approval and consent of the Corporation Commissioner,* and that in the event that the Italo Corporation failed to deliver the said stock to the McKeon Company the latter had the right

> "to retake the properties agreed to be sold or to accept a 60-day note for one and a half million dollars, a 120-day note for one and a half million dollars, and a 180-day note for one and a half million dollars" (R. 306),

upon the assumption that the promissory notes to be delivered in lieu of stock reflected the assumed value of the stock.

While the total consideration to be received by McKeon Drilling Company for its assets upon the basis mentioned in the contract would be approximately $5,500,000, the Italo Petroleum Corporation assuming its outstanding liabilities amounting to $500,000, it is obvious that the actual consideration was much less due to the fact that it would have been impossible to have placed the stock upon the market without "breaking" the market and thus considerably reducing the market value of the stock. (R. 1105.)

On September 18, 1928, at the instance of the Italo Petroleum Corporation and for reasons to which reference will hereafter be made, this agreement was modified, the modified agreement being identified as U. S. Exhibit 85. (R. 306-7.)

Italo directors approve purchase.

As has already been stated, the contract between the parties was signed on July 5, 1928. Its execution, however, had to be ratified by the directors of the Italo Corporation. (R. 1131.) While Robert McKeon had been elected a director of the Italo Corporation, as already pointed out he had never up to this time attended a directors' meeting or had anything to do with the affairs of the company. On July 6, 1928, the directors met for the purpose of giving consideration to and taking final action upon the proposed merger. (R. 1131.) With respect to this meeting Robert McKeon testified:

> "I had never been to a director's meeting and I wanted to become acquainted with the men with whom I had now associated myself, so John McKeon, Gordon Siens and myself went to San Francisco. Our principal reason in going to the meeting was because we knew the directors were going to agree to accept or turn down the proposition for taking our properties into the merger along with these others. I went up as a director and I asked Jack to come up, saying, 'You had better come up and get acquainted with the fellows who will be partners with us now.' We arrived in San Francisco on July 6th at nine o'clock and the meeting convened at ten o'clock, and we were introduced to the various directors who were there at the meeting and we talked about the various properties, both Jack and myself. We had some maps there similar to the colored map in evidence and both Jack and I talked to the same extent that we have discussed the matter here today, showing them the various

properties, and showed them the productions, and showed them the wells, and expressed our opinion of the value of the properties including our own and those taken into the merger, and that is about our interest in the meeting or what we did.

The directors asked us about the various properties already in Italo and those proposed to be taken in by the merger, and our ideas of the value and the possibilities of oil in the various wells, and we told them what we knew about it. They thought we would have more information than they and I believe were dependent upon what we told them. It was my understanding that the contract was to be affirmed by the directors before they became operative. *When the directors had arrived at the point of affirming the contract under consideration, Jack and I withdrew from the meeting because our properties were interested and we were not present when they voted on the proposition to buy all of these properties.* That was the first meeting of the board of directors I had ever attended." (R. 1131-2.)

Upon the same subject John McKeon testified:

"I went up to San Francisco and the deal was all settled and was reviewed by the board of directors. I went before the board of directors at that time and did not conceal from the board any facts which were then facts or any agreements which had then been made. I stated fairly to the board of directors what those properties were and my judgment concerning them. There were no members of the board of directors at that time other than Bob who I dominated

> or controlled in any way." (R. 1208.) "* * * At that time with my knowledge of the properties and of the oil business and of the Italo I thought the transaction that I was entering into not only as to the McKeon but as to all of those properties, was just and reasonable and a very fine deal. It did not occur to me that there was anything in it as the basis of a fraud on anybody." (R. 1209.)

That no misunderstanding ever existed and that no suggestion ever was made that any part of the consideration, to be received by the McKeon Company for its properties, should be turned over or given to any of the officers or directors of the Italo Corporation, or that there was no fraud of any kind connected with the transaction, was definitely established upon the trial. Upon this subject Robert McKeon testified:

> "There was never at any time during the negotiations for the selling of the McKeon property to the Italo Company any understanding that any part of the proposed consideration from Italo Company to the McKeon Company should not be paid but should be divided back among directors or others connected with the Company. There was no agreement of that kind at all. Up to the time of the making of the actual deal I dealt with the Italo Company at arm's length the same as I would deal with anybody else. Even though I was elected as director of the Italo I had forgotten about it and never thought about it. I was sitting on the deal on the McKeon Drilling Company side of the table. I was acting for the McKeon Drilling Company getting the best possible

deal. I did not offer anything in the way of a reward or inducement to anybody connected with the Italo Company to further or encourage our properties. The Italo Company was after us for the deal; I was not after the Italo Company for the deal at all.

I believed at all times that I was making a fair and upright and honest bargain with the Italo Company for the sale of our properties (the McKeon Drilling Company properties to the Italo). There was not at any time preceding the sale any understanding, directly or indirectly, between me and anybody else, or to my knowledge between any other parties, that any part of the consideration that was being paid by the Italo Company under the terms of the contract should be rebated to or paid back or in any way enjoyed by anyone else." (R. 1172-3.)

Upon this same subject John McKeon testified:

"I did not promise any one or more of the directors any reward or compensation or commission in the event the deal was consummated and did not suggest anything of that kind to anybody, and did not authorize anybody else to make such proposition at my suggestion or on behalf of the McKeon Drilling Company.

At that time with my knowledge of the properties and of the oil business and of the Italo, I thought the transaction that I was going into, not only as to the McKeon properties but as to all of those properties was just and reasonable and a very fine deal. It did not occur to me that there was anything in it as a basis of a fraud on anybody." (R. 1208-9.)

Diversion of stock not agreed to or contemplated.

That he never contemplated ever using any part of the McKeon Company's consideration for purposes other than those of the McKeon Company is likewise shown by the following testimony of John McKeon, his testimony being:

> "If I had had any idea that I would later be called upon to use part of the consideration which we were to get for purposes other than the purposes of the McKeon Drilling Company, we wouldn't have considered the deal for a minute. We were putting our properties in, in my opinion, for less than their worth, and putting in clean nice properties in a clean nice proposition. If we had thought there would be any difficulties in the future we would not have considered the deal on any basis." (R. 1207.)

John M. Perata was the president of Italo Petroleum Corporation at the time the transaction was concluded. With respect to this subject he testified:

> "At the time the syndicate was formed and before and after that time I did not have any understanding or agreement with Robert McKeon or John McKeon or McKeon Oil Company or any of the defendants or persons mentioned in this indictment or anyone else that I was to receive any consideration whatever in the way of stock from John McKeon or any other person. There never was any understanding between me and any of the defendants that I was to receive any benefit as the result of the purchase by the Italo Petroleum Corporation of America of the McKeon Drilling Company." (R. 838.)

Paul Masoni, who was a director of the company, also testified upon this subject, his evidence being:

> "In the consummation of any of these deals there was no agreement between Wilkes or Perata or DeMaria, or any of the other defendants and myself that at any time or under any circumstances I was to receive any of the commissions or benefits whatsoever personally from these transactions. There was never any such understanding at any time." (R. 819.)

Wilkes, testifying upon this subject, said:

> "The question of the McKeon Drilling Company only receiving 2,000,000 shares of stock for the consideration of their properties was never discussed by me with anybody and I never understood at any time that the McKeon Drilling Company was only to receive 2,000,000 shares of stock." (R. 726.)

Upon cross-examination he further stated:

> "I never at any time had any conversation with any one of the three McKeon brothers or all of them, in which any price was suggested by them or any willingness on their part indicated to accept a lesser consideration for the McKeon Drilling Company properties than the consideration which was eventually provided for in the contract. The least price ever suggested by them that they were willing to accept for their properties was the $500,000 assumption of indebtedness, the $500,000 in cash and the giving of ten notes payable over a period of ten months, for $50,000 each, and 1,000,000 shares of preferred and 3,500,000 shares of common stock of the Italo Company. They never accepted the deal as

finally set up until it was finally agreed upon." (R. 752-3.)

Fred Shingle, when examined upon this phase of the controversy, testified:

"At or prior to the time that the contract was made between the McKeon Drilling Company and the Italo Petroleum Corporation of America, I did not have any agreement or understanding, tentative or otherwise, with any one of these McKeons that I was to get any part of the stock which was to be issued in consideration of the transfer of the McKeon Drilling properties to the Italo. At that time or immediately thereafter, when the syndicate was being organized, I was not informed by any person that there was any such agreement as to anybody, with the McKeons, that the McKeons were to give any part of that stock to anybody else. So far as I know, each one of these transactions, whereby the McKeons gave, sold or disposed of their stock to various persons, those transactions arose at or about the time they took place, and that is true with respect to the stock which was transferred to Shingle, Brown & Company and to me personally. The stock that was transferred to me personally was transferred to me for the benefit of my firm." (R. 929-30.)

The defendant, Maurice C. Myers, gave like testimony:

"I never entered into any agreement with any defendant in this case or anyone else to accept any secret profits from any deal or deals of any kind or nature in connection with the acquisition

of any properties by Italo Petroleum Corporation of America." (R. 1057.)

Comparable testimony was given upon this subject by the defendants Brown (R. 1012) and Cavanaugh. (R. 1083.)

This brings us to a consideration of the actual value of the properties and assets of the McKeon Drilling Company at the time they were purchased by the Italo Corporation, as to which value there is no conflict in the evidence.

Value and character of assets of McKeon Drilling Company at time of agreement.

It is, of course, obvious that the exact or even the approximate, value of assumed oil-bearing properties is not susceptible of demonstration. In the very nature of things this must be so. Unless the property is within proven territory its potentialities are highly speculative, and frequently when within what is deemed and ofttimes agreed to be proven territory, upon the conclusion of drilling operations it is found to be valueless. It is a matter of common knowledge that inconsequential considerations are often paid for property which turns out to be of immeasurable value, while vast sums are paid for property deemed to be oil-bearing which, when explored, is found to be barren and worthless. As it happens, however, practically all, if not all, of the properties owned by McKeon Drilling Company were not only within what is understood to be proven territory, but all of its completed wells were producing and its *net* returns from oil

products at the time of the sale exceeded $1,000,000 per annum. (R. 1139.)

All of the properties of the McKeon Drilling Company were located in Signal Hill oil field situated near Long Beach, California. (R. 1114.) Defendant's Exhibit LLL (R. 1115) is a map of the Signal Hill oil field. The properties appearing thereon colored in red are those of the McKeon Drilling Company which were transferred to the Italo Petroleum Corporation. (R. 1114.) This map also shows the Graham-Loftus properties which were turned over to the Italo Corporation, colored in green, as well as those acquired from the other companies which are colored in yellow. (R. 1114.) This map also discloses the production in barrels per day from the various wells, around the Hill, and the depth of certain wells which were in process of drilling, on July 5, 1928, the day the contract was executed. (R. 1114.)

The Signal Hill oil field is about 2½ miles long and half a mile wide. (R. 1114.) Robert McKeon's familiarity therewith is demonstrated by the record without contradiction. McKeon Drilling Company started the third well that was drilled on that hill and continuously thereafter was engaged in drilling wells. The McKeons had been identified with Signal Hill since the discovery of oil was made in that field. (R. 1114.) They had not only drilled approximately 100 wells in that territory, but had kept in close touch with the wells drilled by other operators, it being the custom among operators to exchange information concerning wells being drilled. The McKeon Company

had drilled a corps of scouts who met once or twice a week or oftener and exchanged information as to producing or drilling wells, so that such information was known among all the operators. (R. 1114.)

Because of his experience in the oil business Robert McKeon had become familiar with established geological guides that were used by various geologists and petroleum engineers in the estimation of oil production. (R. 1114-15.) All of the properties owned by McKeon Drilling Company had been acquired for the purpose of developing them as oil properties with its own money. No stock was sold or intended to be sold, and all money that went into the development of these properties represented the moneys exclusively of the McKeon Company. (R. 1115.) With respect to the acquisition of these properties Robert McKeon testified:

> "In the acquiring of these properties from 1926 to 1928 I exercised my judgment and best knowledge and information upon the question as to whether they were valuable property and also used the information that had been obtained from others and such geological knowledge as I had. * * * As we acquired these properties I believed that they were the best that could be obtained on Signal Hill, and we made oil wells out of nearly every well we drilled." (R. 1115.)

The real properties turned over to the Italo Petroleum Corporation by McKeon Drilling Company were twelve in number. (R. 1117.) These properties were not only shown on the map (Defendant's Exhibit LLL) but were specifically described by Robert

McKeon in his evidence. (R. 1115, 1117.) At the time the agreement was entered into the McKeon Company had five completed wells which were producing a little in excess of 4300 barrels of oil a day. Within a day or two after the sale the "Knight" well came in, producing somewhere around 2000 barrels a day. (R. 1118.) Between January 1, 1928, and October 15, 1928, when the properties were finally turned over to Italo Petroleum Corporation, the McKeon Company realized in excess of $900,000 from its producing wells. (R. 1118.) The producing wells were equipped with full facilities for handling the oil, such as tanks, derricks, boiler points, tubing, and everything that is necessary for a completed well. The drilling wells were equipped with everything excepting the gas traps and production tanks and such other paraphernalia, which would be finally put on at the completion of the wells. (R. 1118.)

With respect to the condition of the McKeon Company at the time of the transfer John McKeon testified:

> "We were in a very good position at that time, and had a very splendid income and unlimited credit, and we were a going concern probably making a net, above cost, better than a million dollars a year, and our then present opportunities were better than they had been in a long time." (R. 1206.)

McKeon assets valuable and highly productive.

With respect to the McKeons' understanding of the then existing situation, John McKeon testified:

"After the conversation between Bob, Raleigh and myself we agreed after reviewing the properties that were going into the consolidation that if we went in we would have to have a certain amount of cash and approximately one-third of the stock of the company. We felt that our properties and our organization was worth one-third of the other properties that were being consolidated. We realized that we were giving up our identity in the oil business and were giving up the idea of making profits for ourselves; that our efforts would have to be directed to that company entirely, and also, if the company ever got into difficulties, that we would have to be a part at least of the people that would carry it through. With all those things in our minds, we concluded we would have to have at least one-third of the capital stock of that company. We did not consider the capital stock that we were getting as the equivalent of cash at the par value of that stock. We knew that it was stock; that it was necessarily a speculative commodity. We knew that the company had just sold six million shares at the rate of about sixty cents a share to the syndicate and that that money was used to buy properties comparable to ours, and that cash was paid for them. We couldn't be expected to figure that out stock was worth more than they were willing to take for it in cash. We knew it was not the equivalent of cash." (R. 1207-8.)

Upon the question of values the testimony of Robert McKeon is illuminating. On this subject he said:

"In my opinion the properties of the McKeon Company transferred to the Italo Company in

accordance with that agreement, were of a value of five or six million dollars. In considering the value of these properties I base my estimate on the following things. First of all, I had seen many of the oil wells on the hill produce more than a million dollars. We had an income there, above costs, in excess of $100,000 a month, or in excess of $1,000,000 a year profit. We had a number of wells drilling and in various stages of drilling on the various properties, some of them near completed, and it was my opinion that the completion of these wells would increase our present income considerably. I thought it would more than double it. We had in addition to that a complete unit in the oil field development. We had a large crew of trusted and experienced men both as to drillers, production men, engineers, geologists and every kind of man that was needed. We had the finest equipment that money could buy and we could secure leases around there in competition with any company in the country. We had a good organization, and all of those things taken into consideration I don't think I would have sold the properties for five or six million dollars in cash if I had to quit the business." (R. 1139-40.)

And as indicating why under such circumstances he was willing to join the merger, he testified:

"If I were just going to take the money and quit the business I don't think I would have considered that kind of an offer. The fact that I was becoming connected with a larger and growing organization influenced me in the making of the deal. I realized that while we had a number

of wells on this property and a number of wells drilling, they were all located in one field, and that many things could happen in the field. I had always dreaded the thought of a fire at Signal Hill which would wipe out all of the wells on Signal Hill. I knew that I was getting a large interest in many properties on the Hill that were as valuable, possibly some of them, more valuable than mine. In addition to that I was getting an interest in hundreds of acres of proven oil lands, with producing wells on them. An interest in the spread of wildcat or prospective potential oil lands, scattered in many states, even old Mexico, and was getting associated with men whom I thought and knew had great ability, such as Fred Gordon, Alf Wilkes and many of the men in the company. I realized and thought that we were going to have good financial backing, and all those things tended to get me to join in that merger." (R. 1140-41.)

Geologists appraise McKeon Co. assets.

Notwithstanding the individual knowledge of Wilkes respecting the properties to be included in the proposed merger, as well as their value, before agreeing to acquire any of these properties (including that of the McKeon Drilling Company) expert geologists were employed to study and make a detailed report thereon. One of the experts was Dr. Eric A. Starke, an outstanding geologist of vast experience. He had been at the head of the geological department of the Standard Oil Company of California for twenty-three years, and thereafter Chief Geologist for the Union

Oil Company of Delaware, until it was absorbed by the Shell Company of California. Since that time he had been practicing his profession in Southern California. (R. 793.) With respect to his employment in connection with the properties here involved he testified:

> "In the year 1928 I was employed by the Italo Petroleum Corporation of California through Alfred G. Wilkes to examine a number of properties, including those of the McKeon Drilling Company at Signal Hill." (R. 793.)

With reference to his knowledge of defendant, John McKeon, he said:

> "I have known John McKeon for about fifteen years and am familiar with his general reputation in the oil business as a production man. His reputation is very high, being one of the outstanding ones in the State." (R. 794.)

As a result of his investigations, he made a report upon all of the properties examined by him, including those of the McKeon Drilling Company. (U. S. Exhibit 25.) With respect to this report he states:

> "The report which you have shown me, which was made by me, represents my true opinion as to the value of the McKeon properties. In arriving at the conclusions which I did in that report, I used the method of procedure which I customarily and ordinarily used in appraising oil property based upon my experience. In my opinion, the Signal Hill oil field is a long-lived field. I have never yet known a major field in California to die." (R. 794.)

This report, which is quite lengthy, and therefore impossible to reproduce in this brief, is in the possession of the clerk of this court and therefore available to the court for examination. The report places a total net worth on the leases belonging to McKeon Drilling Company at $5,874,818, which did not take into consideration any of its physical properties, such as derricks, equipment on leases, tankage and other equipment. (R. 795.) As showing his lack of interest in the matter this witness testified:

> "I did not have any interest in either the McKeon or Brownmoor property and was paid a fixed fee, regardless of the result." (R. 796.)

He further testified:

> "I never discussed that valuation with the McKeons." (R. 797.)

Charles S. Thomas, another geologist, employed to pass upon the value of McKeon Drilling Company's properties, had been engaged in locating, passing on and valuing oil properties for twenty-two years and had been geologist for ten years for the Union Oil Company of California. About 50% of the work that he had done as geologist had been the appraisal work of oil properties. (R. 786-7.) About the middle of June, 1928, he was employed on behalf of Italo Petroleum Corporation through Wilkes to make a report on the McKeon Company's property on Signal Hill. After testifying to the methods pursued by him in investigating and evaluating oil property (R. 787) and that such methods were pursued in determin-

ing the value of the McKeon properties he testified that in his judgment they were worth $7,537,123. With respect to this valuation he stated:

> "The valuation arrived at in this report on the McKeon properties truly and correctly states my opinion as to what those properties were worth at the time the report was made. (R. 787.) * * * The values which I have placed upon the McKeon properties in this report (U. S. Ex. 25) represent the fair and reasonable value of those properties, as of the time the report was made, which was the summer of 1928, and it was my opinion at that time, and it is my opinion yet, if the conditions there remain the same." (R. 788.)

Concerning his employment to appraise the McKeon and other properties, he further testified:

> "There was nothing contingent about my compensation. It was not contingent upon getting a permit or anything of that sort. Wilkes just asked me to make the report and get it out as speedily as possible." (R. 792.)

In making his valuation, no consideration was given to the equipment upon the property. It was confined exclusively to the assumed oil content of the area. (R. 793.)

With respect to the advice given by him to the Italo Corporation, on recross-examination he testified:

> "In July, 1928, I would have advised and did advise the payment of $7,537,123 for the McKeon properties, and the payment of $6,800,000 for the Graham-Loftus property. By that I mean

that is what I make the valuation at in my report, and I would have advised my client to pay that much money for the property." (R. 793.)

The report made by this witness is equally as voluminous as that made by Mr. Starke and has appended to it maps, diagrams and other documents to illustrate the verity of his report. This report is also a part of U. S. Exhibit 25, which is in the possession of the clerk of this court and therefore available for consideration.

We have already pointed out the extent of the production on the McKeon Company's properties at the time the contract was negotiated, and that from this production the McKeon Company was then netting approximately $1,000,000 a year, without taking into consideration the 2000 barrel well which came in a few days later. (R. 1139, 1118.)

Revenue of McKeon properties analyzed.

Supplementing this testimony and establishing that such production continued after the transfer to Italo, the witness E. J. Byers, who was supervisor of accounting for the receiver of the Italo Corporation and had previously been called as a witness for the government, testified:

"According to the records of that corporation the McKeon properties were acquired October 15, 1928. From that date to December 31, 1928, the gross income for the two and a half month's period was $284,118.55 from the McKeon properties alone. The operating expense of these

properties for that period of two months and a half was $37,942.14, leaving a net operating income from the McKeon properties of $246,176.41. The gross income from the McKeon properties alone, according to the books of the Italo Company, for the calendar year 1929 was $1,056,509.68 and the operating expense was $101,937.19, giving a net operating income from the McKeon properties of $954,572.49." (R. 850.)

At this time the oil business was at its height, there was a great demand for oil and the unanimous judgment of those interested in the oil business was that the price of oil was going up. (R. 1218.) Marketing companies were making every effort to get contracts to cover present and future production. (R. 1218.)

Oil curtailment and its disastrous effect.

During the year 1929 the oil industry of the nation suffered a serious set-back, some of its underlying causes being mentioned in the record. (R. 783-4; 847-8.) According to the books and records of the Italo Corporation, curtailment went into effect on November 1, 1929. Necessarily the regulations enforcing curtailment interfered with what otherwise would have been the normal progress of this enterprise and materially diminished its production and income. Undoubtedly to the disaster, thus occurring to the oil industry, can be traced the financial difficulties in which the Italo Corporation found itself. The effect of curtailment upon the Italo Corporation was shown by Byer's testimony as follows:

"With respect to the normal income from the McKeon properties turned over to the Italo Corporation, allowing a normal decline had the price remained the same and there had been no curtailment, I would say that for the two and a half months' period in 1928 the McKeon properties earned net $246,000 which was approximately $100,000 a month or $1,200,000 per annum. If they had continued to produce on the same basis, without curtailment, and at the same price that they received in 1928, for the period from October 15, 1928, to May 31, 1933, that would be four years, seven and a half months, that is, 55½ months, at $100,000 per month, would be $5,500,000 odd. That is what they would have produced net. Now, there must be taken into consideration the normal decline in wells, so we take 10% off and I would say that they would have produced in excess of $5,000,000 to May 31, 1933." (R. 850-1.)

Oil industry prosperous in 1928.

Upon this phase of the case which bears upon the question of value, Ralph Arnold, an experienced geologist who for many years had been a member of the United States Geological Survey, and while such had examined all of the oil fields in California, testified:

"In the summer of 1928 the conditions in the oil industry were the best that I had ever seen them in my 25 years experience. At that time the prosperity of the oil industry was going up all the time and I felt the oil business was on the uptrend. That was the general opinion among oil men at that time. In 1929, due to the importation of large quantities of oil from Venezuela

> and the natural results of the depression late in that year there was a very decided effect upon everybody's ability to raise money and conduct any business, particularly the oil business. The result of those conditions had brought about the curtailment of oil." (R. 783-4.)

And after testifying that the percentage of curtailment in Long Beach field was from 25% to 50% and that 40% reduction in price was the usual curtailment, with respect to the difference in the price of crude oil between 1928 and 1929, he stated:

> "I don't remember the exact price of Signal Hill crude oil in 1928, but it was about as high as at any time I remember in the oil business. I think it was around $1.50. Since that time the price has gone down to as low or lower than 35¢ per barrel. The decline in price and the curtailment have had a very depressing effect upon the price of oil properties." (R. 784.)

And as showing the probable loss sustained by the Italo Corporation from the properties acquired by it in the merger, due to curtailment, this witness further testified:

> "It seems to me they should have given a profit then of somewhere between three and four times the profit that they made if they had sold all of their oil and at prices which were prevailing in 1928." (R. 784-5.)

Upon this same subject Raymond A. Earle, a petroleum engineer and field superintendent, then employed by the receiver of the Italo Corporation and

prior thereto by the McKeon Company, and therefore familiar with the properties of the McKeon Company, after testifying that curtailment was put into effect upon the McKeon wells in November, 1929, and had remained effective ever since, stated:

> "The original curtailment was 38.54% calculated as follows: In Los Angeles basin the Italo Petroleum Corporation, including Santa Fe Springs, Huntington Beach and Long Beach, for the month of October and prior thereto in 1929, before curtailment, the production of the entire basin for this company was 170,475 barrels of net oil or an average daily rate of 5,499 barrels. That was for all of the wells. For Signal Hill alone, where the McKeon properties were located, for October 1929, 81,441 barrels or 2,627 barrels per day, flowing at a maximum amount, producing at 100%, and then curtailment was instituted in November of 1929 carrying on to the present time, and the production of the entire basin for Italo was cut to 81,883 barrels or a drop of 88,591, barrels over the preceding month or 51.97% for the basin. In Long Beach 58,254 barrels for the month of November, or a daily rate of 1,967 barrels, a drop in production of 27,187 barrels or 28.47% drop in Signal Hill." (R. 847-8.)

This witness further testified:

> "That property is in proven territory, as are all of the other properties of the McKeon Drilling Company." (R. 484.)

And, as showing the condition of the oil industry in 1928, he further testified:

> "At the time the transaction was made, in the summer and fall of 1928, the oil industry was in a very healthy condition and there were no indications of the things that transpired in 1929." (R. 849.)

And as showing a further reason for the decline, he said:

> "The rapid decline had not hit Signal Hill at the time, and the excess oil from Santa Fe Springs was followed later by Kettleman Hills. We could not see those things in the oil industry and were not anticipated in 1928." (R. 849.)

The change in the petroleum business is likewise established by Robert McKeon, whose testimony was:

> "There was a marked change in the condition of the petroleum business following the taking of the properties over from the McKeon Company and these other companies." (R. 1180.)

Proceedings before Corporation Commissioner.

In order to enable the merger to be consummated it was essential that a permit be obtained from the Corporation Commissioner of the State of California. The preparation and filing of this application was entrusted to Maurice C. Myers, attorney for the Italo Corporation. A number of conferences were had between Mr. Myers, the Corporation Commissioner and his assistant, during the course of which additional data was requested, which consisted largely of engineering reports, subsequently furnished by the Italo Petroleum Corporation. (R. 1042.) The proceedings

before the Corporation Commissioner are of interest, because they likewise demonstrate, at least with respect to the McKeon properties, that the purchase price was neither excessive nor unfair.

At the time the appilcation was filed Walter D. Abel was chief engineer of the State Division of Corporations, having served as such under a number of different commissioners. (R. 835.) Touching upon his qualifications for his position he stated:

> "I became chief engineer of the department some time in 1923, and during my employment in the department, I was actively engaged in the examination of either the properties or the reports that were made respecting them, in connection with applications to the Commissioner for permits. There were many such applications and in that employment I became familiar with the various oil structures of the state. My training as mining engineer included also the study of oil geology. I studied the oil geology of the various structures in California during that time, and in 1928 I was generally familiar, as a mining geologist and engineer, with the various oil properties in California." (R. 854.)

After the application for the permit had been filed Abel informed both Myers and Wilkes that before giving their application final consideration he would require them to submit appraisements of all of the properties that were involved in the permit. (R. 854-5.) He was then asked what appraisers would be satisfactory to the Department. Three were named by Abel, any one of whom it was stated would be

satisfactory to the Department. Among the three named were C. A. Thomas and M. H. Soyster. It appeared, however, that Soyster had been employed by the Italo Corporation, so the understanding was that Thomas should be employed to do the work. (R. 855.) Abel testified that he had no interest in any of these men; that their reputation as petroleum engineers and geologists was excellent, and each of them was a man in whose judgment and opinion he had confidence. (R. 855.) It was because he was named by Abel, that Thomas, to whose testimony reference has already been made, was selected. (R. 855.) Thereafter the reports of Mr. Thomas and Mr. Starke, with supporting data were filed with the commissioner. (R. 855.) With respect to the report of Mr. Thomas, Abel testified:

> "At the time I examined the report of Mr. Thomas on these properties, I considered it was made on a sound basis and in accordance with standard engineering practices on property of this kind." (R. 855.)

After the application had been filed, some of the stockholders of the company filed protests and complaints against the issuance of the permit. One of these complaints was filed by W. D. Rorex, a copy of which is set forth in the record. (R. 515; 523.) An examination of this complaint will disclose that, among other things, it was claimed that the properties to be acquired were not of a value in excess of $6,518,000. To these complaints, an answer was filed by the Italo Corporation, and thereafter a hearing was had in the

office of the Commissioner. (R. 524.) On August 9, 1928, findings of fact and conclusions of law were signed and filed by H. A. I. Wolch, Assistant Corporation Commissioner, before whom the matter was heard. It appears from these findings of fact and conclusions of law that practically all of the complaints were dismissed. After referring to certain exhibits filed in connection with the application, as well as the valuations made by certain named petroleum engineers, including Eric A. Starke, C. S. Thomas, Douglas Fyfe, M. H. Soyster and D. R. Thompson, the Commissioner found:

> "that the valuations and appraisals of the property to be acquired by the Italo Company are made by competent engineers, and that said Eric A. Starke, C. S. Thomas, Douglas Fyfe, M. H. Soyster and D. R. Thompson are found to be competent and reputable engineers, and that the tabulation of valuations of the properties to be acquired as evaluated by the said engineers had been tabulated by W. D. Abel, Chief Engineer of the State Corporations Department, as follows:" (R. 524-5.)

Appraisement of McKeon properties by geologists.

The tabulation referred to appears on pages 526 and 527 of the record. With respect to the McKeon Company's properties, Thompson, Thomas and Starke valued them as follows: Thompson, $9,005,188; Thomas, $7,537,123 and Starke, $5,873,818. (R. 526.) It will be recalled that this valuation did not include any of the physical structures, but merely the prop-

erties themselves. The tabulation also disclosed that, in the opinion of the geologists, the lowest value of the actual production from the McKeon Drilling Company's properties was $751,864, and the lowest value of possible production was $3,776,669. The valuation placed upon the equipment of the McKeon Company was $726.695 by Fyfe and $2,750,000 by Soyster. (R. 527.)

Corporation Commissioner finds values fair and issues permit.

After further finding that the sale of the securities purposed to be sold in the manner applied for, was not unfair, unjust or inequitable to the purchasers thereof, and that neither the applicant nor any of its officers or members had engaged or were about to engage in any fraudulent transaction, it was concluded that the permit should issue. (R. 528-9.) A portion of the information furnished to the Corporation Commissioner was the statement of Wunner, Ackerman & Sully, accountants and auditors, who certified that during June, 1928, the income for oil, gas and gasoline produced by the various properties that were to be merged aggregated $354,182.67. (R. 530-1.) At the same time there was also furnished to the Commissioner a *pro forma* balance sheet showing the set-up of the Italo Petroleum Corporation of America, after giving effect to the proposed acquisition of the properties. Except as to the property of the Zier Oil Company, which was valued at the par value of the capital stock issued therefor, all of the properties being acquired were valued at 50% of their appraisal. Upon

this basis the total valuation was $16,980,506, to which had to be added the then holdings and investments of the Italo Petroleum Corporation which, with current assets, aggregated $3,750,732.10. After allowing for $15,900,000, representing the total issued and outstanding stock (including the 12,000,000 shares to be issued for the acquisition of the properties), and also subsequent rights, and all liabilities, including those assumed as part of the purchase price of certain of its properties, the surplus capital upon the basis stated was $3,015,761.78. (R. 732-3.)

Upon the showing made, the investigations pursued and the hearings had, on August 9, 1929, a permit was issued by the Corporation Commissioner

> "authorizing Italo Petroleum Corporation of America to sell and issue 4,500,000 preferred and 7,500,000 common shares of its capital stock to Maurice C. Myers, as trustee for the applicant, for the uses and purposes recited in the application and the papers filed therewith, and in exchange for the transfer and assignment to applicant of the properties described in the application and papers filed therewith and in the manner recited therein, subject to liens, encumbrances and indebtedness not to exceed $2,750,000." (R. 535.)

The reason for the stock being issued in trust was undoubtedly to subserve the convenience of the parties. Upon the subject of this trust, as well as its execution, Mr. Myers testified:

> "At one time Mr. Abel mentioned that they insisted upon a trusteeship in a bank or to name me, and I was reluctant about accepting the responsibility, but I did not refuse it, and the per-

mit came out in that form. The trusteeship was not completely closed for a couple of years. I rendered an accounting as two trustees, really; one was as trustee of the syndicate in the handling of the money, and the other was trustee for the company as to the 6,000,000 shares of stock. * * *

At the conclusion of my trusteeship, accountings were rendered to the company and to the syndicate. To the best of my knowledge and belief, the accountings rendered by me as trustee to the syndicate and the company were true and correct accountings." (R. 1045-6.)

McKeons had nothing to do with securing permit.

In this connection it will be proper to mention that neither the McKeon Drilling Company nor any member of the McKeon family had anything whatever to do with the obtaining of this permit. This is conclusively shown by the testimony of Robert McKeon, who testified:

"It was my understanding that the duty of obtaining the permit fell on the Italo Corporation and I had nothing whatever to do with the application for the permit or the pressing of the permit for the issuance of the stock. If the permit had not been granted under the terms of our contract we would have retained our properties and the deal would have fallen through. I had nothing to do, directly or indirectly, with the presentation of the application for the permit or any of the hearings that were had during the time that the permit application was pending before the Corporation Commissioner." (R. 1130.)

No evidence contradicting or opposing any of this evidence as to value, production, income, retrenchment or its effect, was introduced, and none can be found in the record.

McKeons give Italo more time to pay.

The contract between the Italo Corporation and the McKeon Company provided that the property should be transferred and the consideration paid on August 15, 1928. (R. 1136.) Shortly before such date Robert McKeon was advised by Gordon and Siens that the Italo Corporation would be unable to meet the $500,000 payment, accruing to the McKeon Company on August 15, 1928, due to the fact that its permit had been issued only a few days before and it had not sufficient time within which to raise the money. Accordingly, and without hesitation, an extension was granted by McKeon. (R. 1136.) About this time a deep sand well had been brought in on the Santa Fe Springs property and the McKeon Company had acquired leases in that field upon which it proceeded to drill. (R. 1136-7.) Because of the inability of the Italo Corporation to make the first payment to the McKeon Company, Robert McKeon had some doubt as to whether it would be able to finance itself. (R. 1137.) The contract between the McKeon Company and the Italo Corporation provided that in the event it was carried out, all properties that the former had then in its possession, regardless of when acquired, would become the property of the Italo Corporation. In such event any moneys spent by the Mc-

Keon Company, on the Santa Fe Springs property, would inure to the benefit of the Italo Corporation. On the other hand, if the McKeon Company refrained from acquiring leases or drilling wells on its Santa Fe Springs property and the Italo Corporation deal was not closed it would suffer a substantial loss. (R. 1137.)

Italo in default, McKeons grant extension.

In view of these circumstances Robert McKeon conferred with Gordon and Siens, explained the situation to them and informed them that he was seriously considering notifying them that the contract had terminated. To avoid this they decided to give him a $50,000 down payment, provided a further extension would be granted, which was given. (R. 1137.)

During September, 1928, Robert McKeon erected derricks on the Santa Fe Springs property and started to drill wells, thereby incurring some considerable expense. He then concluded that if the deal was ultimately closed he would insist upon the repayment to the McKeon Company of the money thus expended on these properties. (R. 1137-8.) Still later, the situation, not improving, Robert McKeon informed the Italo Corporation that he had made up his mind to withdraw from the merger. (R. 1138.) To prevent such withdrawal a further payment of $100,000 on account was made, whereupon a written extension was given until November 15, 1928, upon the definite understanding, however, that if the transaction was not consummated by that time the deal

would be declared off and the McKeon Company would retain the $150,000 paid, as liquidated damages. (R. 1138-9.) In giving this extension it was also provided that the property which had been acquired in the Santa Fe Springs district after the execution of the contract should be retained by the McKeon Company. Notwithstanding this understanding, however, as a matter of fact, a portion of the Santa Fe Springs properties were conveyed to the Italo Corporation when the deal was closed. (R. 1186; 1230-1.) This extension agreement is dated September 18, 1928, and is United States Exhibit 85. (R. 307.) Among other things it provides that the McKeon Company agrees to accept the subscription obligation of Arthur Delany to the syndicate, hereinafter referred to, up to $100,000 on account of the purchase price, defers the payment dates of the ten promissory notes for $50,000 each, to be delivered to it as part of the purchase price, and further provides that upon the payment of the balance of the down payment of $250,000 and the delivery of said notes, the Italo Corporation should have full possession of the property described in U. S. Exhibit 44 and the benefit thereof. It also provided that the Italo Corporation should have six months from the payment of the balance of the $250,000 (down payment) to pay the obligations assumed by it under this agreement. (R. 307.)

At this point we deem it necessary to direct the court's attention to another phase of this controversy, the inception of which antedates some of the incidents already narrated, to which in the orderly

course of this statement mention should properly be made.

Formation of so-called "big syndicate".

The court will recall that on July 9, 1928, an application was filed by the Italo Corporation with the Commissioner of Corporations of the State of California requesting authority to acquire the properties and interests described in said application belonging to McKeon Drilling Company, Inc., Graham-Loftus Oil Company, W. W. Pelham, Modoc Petroleum Corporation, Producers Oil Corporation of America, Coalinga Empire Oil Company, Premier Oil Company, Zier Oil Company, Pennsylvania Coalinga Oil Company, Section 71 Oil Company and Maine State Oil Company in return for not to exceed 12,000,000 shares of capital stock of Italo Corporation. (R. 514.)

For the purpose of effectuating such purchase, the application requested authority to sell and issue to Maurice C. Myers 4,500,000 shares of preferred and 7,500,000 shares of common capital stock in exchange for such properties, subject to liens, encumbrances and indebtedness, including current obligations of not more than $2,750,000. (R. 514-15.)

The court will also recall that protests were filed against the issuance of the permit, and that it was only after a full investigation and hearing that the required permit was issued by the Corporation Commissioner. (R. 528-9.) This permit authorized the Italo Corporation to issue the 12,000,000 shares of stock to

Myers, as trustee, because, as stated by Mr. Wolch, Assistant Commissioner of Corporations in charge of the Los Angeles office:

> "Under the permit as issued we authorized the corporation to issue the 12,000,000 shares of stock to a trustee instead of directly in exchange for the properties, as was requested in the application for permit. I desired to create a trustee relationship between the corporation and Mr. Myers, because there was some doubt or uncertainty as to the actual amount of capital that was necessary to purchase certain properties, and there was also a doubt as to the exact number of shares that had to be issued in exchange for the properties. Mr. Myers was the attorney for the corporation, and I required that arrangement with the understanding further that if there was any residue of stock left necessary to acquire these properties that he would hold them as trustee for the benefit of the corporation, to be returned to the corporation for cancellation. That is, as trustee for the corporation, he would return the residue or excess." (R. 860-1.)

After the completion of the so-called $80,000 syndicate, and after the Italo Corporation had concluded to acquire a group of additional oil properties, it was realized that, to effectuate their purchase it would be necessary to have available, sufficient funds to meet the cash requirements of the purchase agreements. In view of the existing circumstances, including the inability of the Italo Corporation to meet such cash requirements, it was essential that a syndicate be formed. The necessity for such syndicate was explained by the defendant Shingle who testified:

"The reason why the syndicate was necessary was because in all of those purchases they would have to be part cash and part stock. For instance, if they needed a million dollars to buy a certain property they would have to have $250,000 in cash, and it was in respect to raising cash that they were interested in having us form another syndicate." (R. 898-9.)

Wilkes and Vincent first approached Shingle and Brown with the proposal that the necessary cash be loaned by Shingle, Brown & Company to the Italo Corporation, but such proposal was declined because, as stated by defendant Brown,

"it calls for anywhere from $1,000,000 to $2,000,000 and we did not wish to undertake to raise that among our friends." (R. 974.)

It was finally stated by Wilkes and Vincent that if a syndicate were formed

"they would interest their friends in becoming subscribers to the syndicate and that people close to the company and other friends of theirs, they thought could raise the requisite amount of money." (R. 974.)

In this connection it was further stated

"that some of the officers or directors of Italo Petroleum Corporation intended to become subscribers to the syndicate." (R. 974.)

That there would be no impropriety in such action on the part of such officers or directors is made manifest by the testimony of Brown, who said:

"At that time I did not consider there was any impropriety in any officer or director of Italo Petroleum Company becoming a syndicate subscriber. If the people who were interested in the company's welfare were not interested in the syndicate designed to assist the company in its future growth I don't know how they could expect anybody else to come in, and that is what I thought about it at the time." (R. 974-5.)

Shingle syndicate manager.

After a number of conferences between Wilkes, Vincent, Shingle and Brown it was finally agreed that the defendant Shingle would assume the responsibility of managing the syndicate, but not the responsibility of raising the money. (R. 897.) It was intended that the syndicate, when formed, would agree to underwrite or purchase a certain number of shares of Italo stock, either the whole or a substantial portion of which was intended to be sold.

As cash was required by the company in the acquisition of these properties, the syndicate would advance to it cash representing funds contributed to the syndicate by the subscribers, or moneys derived from the sale of the stock purchased by it, or from both sources. In order to persuade the formation of the syndicate, as well as its management by Shingle, Vincent asserted that by increasing his sales force a quantity of stock sufficient to meet the purchase requirements could be sold by his company within a period of probably six months or a year. (R. 899; 975.)

There was, however, no way of ascertaining whether the stock could be sold fast enough by Vincent to meet these payments. In fact, it was practically certain that it could not. Therefore the syndicate would anticipate his ordering more of the stock. (R. 976.) It was also understood that neither the defendant Shingle not Shingle, Brown & Company were to undertake to sell the Italo stock except by wholesaling it to Vincent & Co. and, if necessary, to other agencies outside of the latter's field. (R. 976.)

The purpose of the syndicate, as originally designed, according to Brown,

> "was to take title or options on all of these various properties that were being assembled together, turn them over to the company in exchange for 12,000,000 shares of stock, pay the amount of stock necessary to purchase these properties, that is, the stock considerations, and pay the money necessary to purchase them up to a certain amount." (R. 975.)

Syndicate agreement approved by Corporation Commissioner.

This proposal, however, was changed because of the provisions contained in the permit of the Corporation Commissioner. (R. 975.) The plan of acquiring these properties with the cooperation of the proposed syndicate, as well as the syndicate agreement itself, was submitted to the State Corporation Department, and by it approved and ratified. (R. 303.) The substance of the syndicate agreement, as well as the substance of the agreement between Italo Petroleum Cor-

poration and Maurice C. Myers trustee, is contained in the record. (U. S. Exs. 83 and 84.) (R. 302-4.)

The group of properties under consideration at the time the syndicate was first agreed to was substantially the same as those finally purchased, excepting that the Edwards and Gilmore properties were eliminated and the Graham-Loftus and two other small properties were substituted in their place. (R. 900; 977.) As the properties proposed to be acquired were changing, the amount of stock or cash necessary to acquire them was also changing. Some of the properties required additional stock beyond the original estimates and the Graham-Loftus property called for the payment of $3,000,000 cash, $1,000,000 as a down payment and the balance in monthly installments. The other properties also required cash and stock. (R. 977-8.) It was this change that necessitated the issuance of 12,000,000 shares of stock in lieu of the 10,000,000 shares covered by the original proposed syndicate agreement. (R. 900; 977-8.)

Under the agreement as executed the syndicate manager was to receive as compensation 2½% of the profits of the syndicate, not exceeding, however, $50,000. It authorized Shingle, as syndicate manager, to advance for the purchase of the properties, out of the syndicate funds that were subscribed, up to $500,000. (R. 900; 977.) As a matter of fact, syndicate funds on account of the purchase of the properties were advanced before the permit was issued authorizing the issuance of the stock. These advancements, however, as between Italo and the syndicate manager, were in

the nature of loans, repayable with interest. In other words, according to Shingle:

> "If the big deal had not gone through the only thing that would have happened would have been that we would have got our money back plus interest." (R. 901.)

On this same subject defendant Brown testified:

> "Under the terms of our syndicate agreement we had a right to advance $400,000 or $500,000 to the company in the form of stock so that if the deal did not go through we would become a creditor of the company in that amount." (R. 977.)

Before going into the final syndicate agreement both Shingle and Brown had numerous discussions with Vincent and Wilkes concerning the properties that the Italo Corporation proposed to acquire. To satisfy himself Shingle went to Los Angeles and there conversed with defendant John McKeon. With respect to the subject-matter of this conference Brown testified that upon Shingle's return to San Francisco he told him that he

> "had had a long talk with Jack McKeon in whom he had very great confidence and that Jack considered it a particularly favorable time to pick up producing properties, particularly of the character which they were picking up here in the basin, that Signal Hill production was naturally running down, although they had found deep sands shortly before, but naturally that would exhaust itself in time; that the light oil production stuff was decreasing in a general way. It

was a very good time to pick up these properties because he considered that the value of oil would increase, that a producing unit would be of very great effect in this state and have a chance to make a big oil company; that he considered the properties were being purchased cheaply; that if a deal was made respecting the McKeon Oil Company he expected to turn it in at a fair price." (R. 976.)

Upon the same subject Shingle testified:

"I had known Mr. John McKeon for a great many years and thought a great deal of him as an oil man. I went to Los Angeles and had a talk with Mr. McKeon to find out if Wilkes was really on the right track, in his statement to me that he was buying these properties or had an opportunity to buy them at what he considered a very cheap price. Jack McKeon was in the Richfield Oil Company at that time and he told me that Wilkes was on the right track and in his opinion there never was a better opportunity to buy oil properties than there was at that time, and that it would have to be bought with some cash down payment. He told me he did not care much about the refining end of the business but he was very enthusiastic about the production end and that it had a great future. I went over the proposed program with him generally and mentioned to him the various properties that Mr. Wilkes told us he contemplated purchasing and a rough draft of the prices that Wilkes figured he would have to pay for the properties, and Jack McKeon said he thought the prices were very cheap. He also said that practically all those

properties would have a good future because they had plenty of extra space to drill on." (R. 903.)

Before the agreement was executed a conference occurred with respect to the proposed value of the properties that were to be acquired and computations were made as to the prices which these proposed transfers would reflect upon the stock of the Italo Corporation that would be issued. (R. 903.) According to Shingle:

> "There was considerable discussion on between Brown, myself and Wilkes. We were trying to arrive at a fair price which the company should get and also at a fair price which the syndicate should give. The only basis we had to go by was the last sale of stock which the company had made, practically a month previously, to Vincent & Company, whereby they had a contract, but not a commitment, to purchase Italo units at $1.50 a unit less 15%, which would mean $1.27½ net to the company. Wilkes was quite anxious to have the syndicate pay as close to that price as possible." (R. 904.)

Both Shingle and Brown, however, took the position that the syndicate should derive some advantage from the cheap price at which the company was getting the properties, and called Wilkes' attention to the fact that the syndicate in the commitment would be buying about 2,000,000 units of stock which would be paid for within a brief period, while Vincent, who was paying $1.27½ per unit, was not obliged to purchase any quantity of stock and could obtain stock at that figure as desired. (R. 904.) After a number of discussions

it was finally agreed that the syndicate should pay $1.16⅔ per unit for the stock. (R. 904.)

The syndicate agreement.

The original syndicate agreement was revised in July, 1928, for reasons already stated. While the agreement itself is in evidence (U. S. Ex. 83, p. 304) its important provisions were correctly described by Shingle in the following language:

> "The permit provided for the issuance of 12,000,000 shares of stock to Maurice Myers, trustee, of which 7,500,000 were common shares and 4,500,000 preferred shares. The syndicate was to receive 3,000,000 shares of preferred and 3,000,000 shares of common, for which they were to pay the company in cash a sum around $3,500,000. That is, the commitment for properties that the company was to acquire called for cash payments of something between $3,400,000 and $3,500,000, in cash and also called for the exchange of a certain amount of stock which was approximately 6,000,000 shares divided into approximately 4,500,000 shares of common stock and 1,500,000 shares of preferred stock. The company was proposing to take over these properties subject to obligations which amounted to approximately $2,750,000. Ultimately the syndicate agreement operated this way: 12,000,000 shares of stock issued under the permit were issued to Maurice Myers as trustee; he turned over to Shingle, Brown & Company, as escrow holders, 3,000,000 shares of common and 3,000,000 shares of preferred stock to be delivered to me as syndicate manager when, if, and as I paid for it." (R. 905-6.)

After the permit was issued and the syndicate agreement signed and revised, Shingle, as manager of the syndicate, made a contract with Vincent & Company which required Vincent to sell 500,000 units of Italo stock at a price of $1.60 net to the syndicate. (R. 906.) In the agreement with Vincent & Company it was provided that it should sell 300,000 units of stock on or before September 15, 1928. (R. 906.) This requirement was inserted principally because the arrangement for the purchase of the Graham-Loftus properties, called for an installment payment on September 20, 1928, of approximately $650,000. If this provision had been complied with Vincent and Company would have had to pay to the syndicate manager by September 15, 1928, $480,000. (R. 906-7; 983.)

At the time the contract between Vincent & Company and Shingle, as syndicate manager, was executed, a verbal agreement was made with Vincent that while he was selling the 500,000 units no option would be given to sell any of the remaining syndicate stock in California. Because of this understanding, as well as to endeavor to place the Italo stock on the New York curb, Shingle went to New York. (R. 906.) He was accompanied by Wilkes who, apprehensive lest sufficient cash would not be available to make the necessary payments upon the properties being acquired and to enable the Italo Corporation to develop the properties, had been in correspondence with some of his old associates in New York, who had been with him in the Union Oil, Delaware and Commonwealth Companies, to ascertain if they would be interested in

joining the syndicate or assisting in the financing of the company. While Wilkes was able to interest some of these men in the project, the main group that he really wanted to interest informed him that a three and a half million dollar project was not large enough to justify the expense that they would be put to in joining the enterprise, but that if he would return to California and acquire additional properties and then propose a refinancing connection they would be interested in undertaking the underwriting of its securities. (R. 723.) According to Wilkes:

> "The purpose of my trip was to interest these former banker friends of mine who had been in these other big companies with me." (R. 723.)

Graham-Loftus contract requirement causes anxiety.

On September 20, 1928, there was a payment due to the Graham-Loftus Company which, with accrued interest, amounted to approximately $650,000. The payment of $350,000 had already been made on this property and its stock was in escrow. Unless the installment and interest was paid the stock could have been withdrawn, the money forfeited and the properties lost. (R. 724; 907.) While Wilkes was in New York he received information that things were not well in California and that the money with which this payment should be made was not coming in. Accordingly he hurried back to Los Angeles and on the night of September 19th, one day before the payment became due, received information that the Graham-Loftus Company had brought in their Lightner No.

4 well which was reported to be the largest well in the field, producing better than 5000 barrels per day. (R. 724.) Prior to the bringing in of this well Wilkes was of the opinion that, in the event of a partial payment an extension upon the balance could be obtained, but as testified to by him:

> "With that well coming in, in my opinion it pretty nearly doubled the value of the property and I was very much afraid that they would take advantage of the contract to forfeit what we had paid and take back their property." (R. 724.)

According to Wilkes, who returned from New York about the 10th or 15th of September:

> "Mr. Brown reported to me that the company had a payment due on the Graham-Loftus properties of somewhere in the neighborhood of $600,000 in principal and another $50,000 or $60,000 in interest. The syndicate had already paid on the Graham-Loftus properties around $300,000 or $350,000. If that second payment was not made the syndicate and the company would have lost the $350,000 they put in towards the purchase price of the Graham-Loftus properties because the Graham-Loftus people had a right to forfeit under the contract." (R. 907.) * * *
>
> "Another thing that was very serious was that the day that the Graham-Loftus payment became due they brought in a tremendous well and there was every reason in the world to think that they would be very glad to have us not make that second payment because that made the property very, very much more valuable right away." (R. 908.)

Financial situation of Italo becomes acute.

This acute situation is described by Brown as follows:

> "I was in Los Angeles about September 18th or 19th, 1928, and participated in some of the transactions with respect to the borrowing of money from the Farmers and Merchants National Bank. About that date we had this large amount of money coming due on the Graham-Loftus properties under the escrow with the Bank of America. On that morning we were scrambling around trying to find out how to get the money to make the payment, and there was a feeling it could be postponed a few days. On the 20th, when all of this money was due, came the word they had brought in the Lightner well making 4000 or 5000 barrels, and there was a grave concern at that time whether the Graham-Loftus people would continue to give us any continuances whatever. Things were really in a very desperate and serious state. I had a meeting with Mr. Wilkes and Jack McKeon and Gordon and one or two others and we had several conversations respecting the situation." (R. 983-4.)

In referring to this situation John McKeon testified:

> "After the transaction was made (confirmation of the contract on July 7, 1928) I paid no further attention to it. I was very busy running my own business until about September 18th or 20th, 1928. Mr. Wilkes had left shortly after that deal was closed and the other deals closed, for New York to make his financial arrangements.

Mr. Vincent was supposed to raise the money necessary to meet the early payments on the different properties, and I imagined everything was going along alright, not being in touch with him, until about the 18th of September, when Mr. Wilkes came back from New York and came to my office immediately to see me and said that things were in a very bad condition, that he hadn't made any immediate arrangements in New York, that Vincent apparently had not raised any money, that there was $600,000 due the next day on the Graham-Loftus properties and I believe they had already paid the Graham-Loftus $400,000, and that he was satisfied it would be impossible to get any extensions on the Graham-Loftus account because they had $400,000 and had brought in a 5000 barrel well in the meantime, and that if he wasn't able to make his payments he would lose those properties and also the $400,000, and that would probably stop him and his plan altogether, and that the project would become a failure. I believe he said that up to that time the syndicate had expended close to a million dollars for the benefit of this Italo consolidation. * * *

Wilkes said, 'Unless something can be done immediately we are in a state of total collapse. The syndicate will lose its money and the Italo will lose its property and we are right up against a gigantic failure'." (R. 1209-10.)

The situation with which the parties was confronted was that, although the Graham-Loftus payment amounting to $600,000 and interest was due no moneys were available to meet such payment. The syndicate

had already paid out in the neighborhood of a million and a half dollars on the various properties that had been purchased and was therefore without funds to render any assistance with respect to the matter in hand. According to Brown,

> "Things were really in a very desperate and serious state." (R. 986.)

John McKeon rescues Italo.

In an attempt to find some solution to the problem Wilkes, Shingle and Brown appealed to John McKeon, finding that he was as much worried as they were. (R. 907.) The result of the meeting was that John McKeon went to the Farmers and Merchants Bank and arranged for a loan to Fred Shingle, as syndicate manager, of $300,000. The bank refused to make the loan, however, unless the note of Shingle was endorsed by John McKeon, and, in addition thereto, 2,000,000 shares of the stock of Italo Corporation, held by the syndicate, was put up as collateral. (R. 908.) Shingle and Brown told McKeon that it was doubtful whether they had a right to put up that stock, whereupon John McKeon agreed to indemnify the syndicate against loss, and further agreed that if there was any loss to the syndicate he would make it good out of the stock of the McKeon Company. (R. 908.) It was necessary, however, to borrow another $300,000. This was accomplished by John McKeon through William Lacey, a friend of his, who borrowed the $300,000 from the Farmers & Merchants Bank, putting up his own security. (R. 908.) This loan was likewise endorsed by John McKeon. (R. 1210.)

The indemnity agreements were also joined in by the Italo Corporation and F. V. Gordon. (R. 908-9.) Upon this subject John McKeon testified:

> "I believed it was a wise thing to hold these properties. Mr. Wilkes felt that if this one hump could be gotten over and that big payment made, that the financial program would be gotten under way and from there on we could handle the situation. However, if we couldn't handle that, he didn't think there was any use of going further with that particular financial set-up. So I called upon my old friend, Mr. William Lacey, who had been my friend for years; he had been in a great many oil deals with me, the two of us together, and he had already put $100,000 in the syndicate. I called Mr. Lacey and Fred Gordon together and went to the Farmers & Merchants Bank and made arrangements to borrow $600,000. Mr. Lacey gave his note for $300,000, and I signed the note. Fred Shingle or Horace Brown was with us, and the bank wanted two million shares of stock security on the other note. Mr. Shingle didn't feel that he had authority to put the stock up so I agreed with Mr. Shingle that our properties were going into the consolidation and that if we had any trouble on that stock I would reimburse him from the McKeon Drilling Company stock for the stock he was putting up out of the syndicate, and he put it up. That was the first agreement that I ever had as to the distribution of any of the McKeon Drilling Company stock." (R. 1210-1211.)

And as showing the effort put forward by John McKeon to save the situation, he further testified:

> "The $600,000 was paid to the Graham-Loftus people on the 20th day of September. It had to be paid on time. I believe I had to get the bank to keep its doors open a little while so that we could get in with the money." (R. 1211.)

The price demanded for the Graham-Loftus properties was reduced from three and a half million to three million dollars as a result of the efforts of John McKeon. Upon this subject he said:

> "I had known Mr. Graham for years and had drilled several wells for him. I had a conversation with him in connection with the transaction by which Italo acquired the Graham-Loftus properties. Mr. Wilkes had done the negotiating with Mr. Graham and he asked me to go over and talk with Mr. Graham and find out if we couldn't get him to accept some of the Italo stock, all or part of the payment in Italo stock. I did that. I went over and asked Mr. Graham to accept half of his money in cash and half in Italo stock. He said he would not take any part of it in Italo stock at all, that he wouldn't give his properties for the whole capitalization of the Italo Oil Company; that he wanted to sell for cash and that he would consider nothing but cash; but after the conference there I had with him, he did agree to come down from three and a half million to three million." (R. 1211-12.)

It appears that the Graham-Loftus property was presented to the Italo Corporation through the circumstance that Graham and Loftus, because of their advanced years, were anxious to sell their properties. A broker endeavored to sell them to the Richfield Oil

Company, but John McKeon, who was then handling the Richfield production, stated that Richfield could not handle it, but that Italo might, and sent him over to see Mr. Wilkes. Instead of meeting Wilkes he took the matter up with Siens, who initiated the negotiations resulting in the acquisition of this property by the Italo Company. The broker told Mr. McKeon that if he made the deal he would give him a third of the commission. (R. 1212.)

Vincent causes financial difficulties.

As quickly as the $600,000 was borrowed and the Graham-Loftus installment paid, Wilkes went to San Francisco and contacted Vincent who told him that he had sold a lot of stock but it was on the partial payment plan and he had not the money. (R. 726.) Upon visiting the Italo office Wilkes was advised that continual complaints had been coming in from persons who claimed that they had purchased Italo stock from Vincent and that although it was fully paid for they were unable to get their stock. Although this information was revealed to Vincent, Wilkes could get no satisfaction from him. (R. 726-7.) After discussing the matter with Shingle, upon inquiry of the Bank of Italy he learned from a confidential source, that Vincent & Company had on deposit with that bank over $400,000. (R. 727.) In the meantime Vincent had formed a company called the "Cal-Italo Company", the stock of which he was selling to people who believed they were purchasing Italo Petroleum Corporation stock. (R. 727-8.) It was also learned

that he was attempting to persuade holders of Italo stock to exchange it for Cal-Italo stock. (R. 728.)

As a result of conferences between Wilkes, Shingle and Brown, it was concluded to cancel the Vincent contract and form a broker's pool through which stock could be sold on the market. (Shingle, R. 910-11; Wilkes, 728-9; Brown, 986-8; 990.) This group of brokers conducted intensive investigations for about ten days or two weeks before they finally agreed to go into the deal. Around October 15, 1928, or shortly prior thereto, they definitely agreed that they would go ahead with the proposition. They insisted, however, as a condition precedent, that the contract with Vincent & Company be cancelled, giving as reasons that there had already been a great many rumors around San Francisco that the stock was oversold because Vincent had not been delivering the stock sold by him, and that he was not a member of any qualified exchange and sold stock entirely through salesmen. (R. 990.) The proposed pool members would not associate the Fred Vincent and did not want to have anything to do with him. (R. 903.)

With the set-up of Lacey, as president, and his associates as some of the directors, as will hereafter be shown, two brokers' pools were formed by the brokers mentioned which undertook to sell the stock. (R. 913.) Upon their formation an option was given it by Shingle, as syndicate manager, covering 2,500,000 shares of common stock at various prices. (R. 913.)

Cancellation of Vincent contract.

In accord with the demands of the brokers, on October 15, 1928, the Vincent option contract was cancelled. Before making any commitment to the brokers' pools Shingle inquired of Vincent as to the number of shares he had sold that had not been reported or taken up, stating that he wanted to know his position and wanted to be fair with him. (R. 913-14.) Vincent responded by stating that he would require around 120,000 units. (R. 914.) With this information in mind, Shingle, as syndicate manager, set aside, out of the syndicate stock in escrow with Shingle, Brown & Company, the 100,000 shares optioned to Lacey, the 120,000 units which Vincent said he would require, and sufficient shares to satisfy certain other options given to a group in New York. This stock, with 2,500,000 shares of common stock optioned to the pool members, absorbed all the common stock which the syndicate had available. (R. 914.) Shortly thereafter Vincent reported to Shingle that he had sold more stock than he had reported; that he had made a mistake and instead of being short 120,000 units, was in fact short about 400,000 units, and demanded that the syndicate take care of it. Finally he employed Joseph McInerney to represent him. Mr. McInerney threatened that unless the matter was settled he would procure an injunction to enjoin the syndicate from selling any stock. (R. 914.) With respect to this Fred Shingle testified:

> "It was my opinion at that time that the filing of a suit would be very detrimental because the company had entered into these contracts to

make these cash payments. We had no one but the syndicate to rely on for cash to make the payments. Vincent was one of the main instigators in getting the syndicate started and he was double-crossing us, and a temporary injunction preventing us from furnishing the stock from the syndicate to buy these properties would have been very serious." (R. 914-5.)

The controversy with Vincent is likewise disclosed by defendant Brown (R. 990-2) and defendant Wilkes. (R. 731-3.)

When this alleged large shortage was reported to Wilkes he attempted to have Vincent's books audited, but was advised by the auditor who was sent there that it was impossible for him to tell what Vincent's position was. (R. 732.) A day or two later Mr. McInerney, Vincent's attorney, telephoned Wilkes, stating (according to Wilkes' testimony):

> "If I was not in his office before 3:30 that afternoon a suit would be started at 5 o'clock." (R. 732.)

Vincent's attorney threatens injunction.

In the conference which occurred, Mr. McInerney informed Wilkes:

> "Somebody is going to take care of it, and I will give you forty-eight hours in which to get this matter straightened out and if it is not straightened out to Vincent's satisfaction I am going to start suit against the Italo Company for damages; that Vincent was the fellow who made the company and had been its fiscal agent at all

times and had gone to a lot of expense and had lost a lot of money, and if it was not straightened out in forty-eight hours he was going to start suit against Fred Shingle, syndicate manager, to stop him from selling any of that stock." (R. 733.)

That McInerney's threat, if carried out, would vitally affect Italo, as well as the market value of its stock, is portrayed by the testimony of Bradford Melvin, one of its attorneys who participated in the conferences with McInerney, his testimony being:

"The first one took place in my office, which was then in the Financial Center Building in San Francisco. Vincent and McInerney, and I think it was Brown and not Shingle, but I know one of them was there, and a great argument developed over this claim. At that conversation nothing very definite transpired. It was more of a dog fight than anything else. The next day or the day following that the same parties met in McInerney's office in the Mills Building, and on that day McInerney got pretty insistent that the matter be disposed of, and he threatened that if it were not disposed of either by paying cash or delivering the stock that they were demanding that he would bring some sort of a proceeding to have an injunction issued against the pool, this brokerage pool, which Mr. Carnahan referred to, which had been created at the instance of Italo in order to get money in fast enough to pay for these properties, and he knew that if an injunction was issued against that pool that it would cripple the whole situation and the stock would become worthless, and that was quite——

> The Court. Is that what he said?
>
> A. Yes. Now I am saying that it was a very adequate threat to force the settlement. As a result of that threat the settlement finally arrived at was arrived at. * * *'' (R. 881-2.)

Wilkes immediately went to Los Angeles and explained the situation to John McKeon including the fact that Vincent & Company was threatening to file a lawsuit and "bust the whole situation up". (R. 734.) Finally McKeon said:

> "Well, I will tell you what I will do. Go back and make the best deals you possibly can with him and whatever deals you will have to make I will just have to take care of it personally, that is all there is to it. If we have to give him some little stock to take care of him, why sell him some stock at a cheap price, I will have to do it." (R. 734.)

Wilkes then returned to San Francisco and ascertained that Vincent's account had been audited and that he was over 400,000 units short, which represented stock sold by him, some of which had been fully paid for and other portions of which had been partially paid for by its purchasers. (R. 734.) The result of this audit is conceded by Stratton, where he states:

> "The audit disclosed that we were 400,000 odd units short of stock that we had sold and not delivered." (R. 433.)

McKeon again comes to rescue of Italo.

John McKeon finally agreed to provide the stock necessary to take care of the stock which Vincent had sold but had not delivered to the purchasers thereof. With respect to this matter Shingle testified:

> "We made arrangements with Jack McKeon to supply Vincent and Company's customers to whom he was committed. Jack McKeon agreed to provide the stock necessary to do that out of the McKeon stock held in escrow with Shingle, Brown & Company. The stock was provided from the McKeon escrow with Shingle, Brown & Company." (R. 916.)

Upon the same subject Horace J. Brown testified:

> "With reference to the assurance that I had received, that the balance of the stock would be made up some place else, I had some telephone conversations and also some conversation with Mr. Wilkes who had gone down to Los Angeles to talk the matter over with Jack McKeon. As near as I recall, Jack McKeon said he would make the thing up and try to settle the thing in order to make the thing move forward. The situation was in very bad condition. If somebody threw a suit in there or attempted to enjoin the syndicate, we might as well quit right there. We had a lot of money to pay the next 60 days." (R. 992.)

That John McKeon appreciated the result of litigation with Vincent and the necessity of avoiding it even though the McKeon Company would sustain financial loss, is shown by his testimony:

"With reference to Exhibit 297 and to the entries thereon, Items 36 and 48, showing Bank of Italy, Vincent & Company's market losses, 125,000 units, or 250,000 shares of Italo stock that was given by me to Frederick Vincent, that stock was given to Frederick Vincent to get him out of the picture so that we could get rid of his contract, because of his unsuccessful operation of the sale of the stock, and was not given to him to compensate him for any market losses. I did not know of any market losses, but I knew of the controversy that was on between Vincent and the company, and knew that he was making this demand, and unless his demand was met that he could cause trouble enough that would turn the whole business upside down, so therefore I was willing to settle. I knew at that time that Frederick Vincent had failed in his efforts to sell the stock and turn the cash over to the syndicate so that the company could meet its cash obligations." (R. 1234.)

"* * * After the $600,000 was borrowed and Wilkes went up to see Vincent, Wilkes returned in a few days and said Vincent was not going to be able to fulfill his contract, that he had not sold any stock or at least had no cash available, and that the 15th day of October was going to find us in the same condition as the 15th of September had; that some drastic changes had to be made. He got in some trouble with Vincent and said that at this time Vincent was threatening. I believe Wilkes was negotiating then with Shingle-Brown to take over the financing. Vincent wouldn't agree to that and was threatening a lawsuit, and we all realized that a lawsuit and

an injunction at that time would completely break down the financing and kill it entirely. No brokers would come in under those conditions and no one would want to buy stock under those conditions, so that something had to be done with Vincent. I would say that was probably about October 1, 1928.

"Wilkes told me that the company hadn't any way in the world of settling with Vincent. They had no stock and if I did not come to the rescue of the company at that time he was again in a very bad hole. I said of course we were all going in the hole, so I didn't give Mr. Wilkes any decision but called my brothers over to talk the matter over with them." (R. 1212-13.)

John McKeon reviewed situation with brothers.

John McKeon thereupon called his brothers together for the purpose of canvassing the situation with them. During the course of the conference John McKeon reviewed what had occurred after the arrival of Wilkes from the east, and after informing his brothers about the borrowing of the $600,000 to meet the payment due on the Graham-Loftus properties, his endorsement of the notes and the execution by him of the indemnity agreement, according to Robert McKeon, said:

"In addition to that I have assured them, that is, the other signers of the paper, that if they would secure the money at this time, we would close up our deal with them and go in and put the company over. It has got to the point now where most of the money that has been sub-

> scribed to the syndicate is in there because we are in the deal. We have to close this deal up and take our coats off and go to work and get our properties over there, and you fellows have to go and take charge of the field operations." (R. 1141-2.)

He then called his brothers' attention to the fact that Shingle-Brown Company and another group of brokers were going to take over the sale of stock or the refinancing of the syndicate, so that the initial payments on the properties could be made; that Lacey had agreed to become president of the company and that just as quickly as he could he was going to leave the Richfield Oil Company and take charge of the Italo properties, and

> "that the only thing for us to do was to close up the deal with Italo and make a real company out of it. He said the first thing that had to be done was to get Vincent out of the way. He said he was misrepresenting things to the public; that he was causing a lot of dissatisfaction among the stockholders, selling stock that he was not delivering; that he was not paying any money into the syndicate, and that the very first thing to do was to get him out of the way; and he said that he had agreed with Wilkes, or if Wilkes could get him (Vincent) out of the way, that he (John) would furnish some stock to do that out of the stock that we were to receive for our property, that he would furnish that stock to get Vincent out of the way, so Shingle and Brown and the other San Francisco brokers could take over the underwriting or the financing of this company." (R. 1142.)

John's brothers were very much provoked at him when they learned he had endorsed and guaranteed the payment of the $600,000 worth of notes. Quite a heated argument resulted, whereupon Robert McKeon said to him:

> "I told him that when I made the deal I made a good, fair deal and made just as tough a deal as it was possible for me to make with Wilkes or with Italo; that I had safeguarded our interests in every possible way, and that it was rank foolishness for him to have given up that position." (R. 1143.)

After a great deal of argument and discussion, however, the brothers agreed that because of the position in which John found himself, there was nothing for them to do but to go on with the deal. (R. 1143.) Thereupon Robert McKeon moved over to the Italo and took charge of their field operations. (R. 1143.)

McKeon Company replaced stock sold by syndicate.

It will be recalled that the syndicate manager set aside 122,000 units of stock to take care of what was then believed to represent the commitments of Vincent & Co. Through some inadvertence on the part of the syndicate's auditor, who had not been advised that any of the stock that had to be supplied to Vincent & Company in excess of the 122,000 units was to be furnished by the McKeon's, the syndicate sold to Vincent 46,819 shares of common and 66,819 shares of preferred stock beyond the stock then available for sale. (R. 1000-1.) In accord with their previous agreement to supply this stock and thus

avoid the threatened litigation, as well as financial loss to the Italo Corporation, the stock thus sold was replaced in the syndicate by the McKeons out of the escrowed stock coming to them. (R. 1001.) The purchase price paid by Vincent to the syndicate for the stock previously sold to it was then turned over by the syndicate to the McKeon Company. This stock is represented by items 14, 17 and 44 in U. S. Exhibit 297. (R. 595-7.) The sum thus paid amounted to $86,310.40. (R. 1001-2.) On this subject, among other things, defendant Brown testified:

> "With respect to the $86,310.40 which went into the syndicate account and was then taken out of the syndicate account and delivered to the McKeon Drilling Company, that sum represented the amount received by the syndicate manager for the sales of stock over and above the 122,000 units that Frederick Vincent was entitled to receive, so that when the matter was discovered the McKeon stock was placed in the syndicate and the $86,310.40 was taken out and delivered to the McKeons for their stock which had been placed in the syndicate." (R. 1001-2.)

The transaction in substance was that instead of the auditor delivering the stock to Vincent & Company directly from the McKeon escrowed stock as he should have done, he delivered shares from the syndicate stock, which he replaced with McKeon escrowed stock, there being at all times sufficient escrowed stock available to make such delivery.

Stock escrowed with Bank of Italy.

Because of their distrust of Vincent and in order to be assured that the stock to be supplied by the McKeons would actually reach those to whom Vincent & Company had sold stock, an escrow was created with the Bank of Italy under which Vincent & Company was required to furnish lists of the names of both fully and partial paid subscribers and the shares of stock due to each. The stock was then delivered to the bank and by it to the subscribers in accord with the provisions of the escrow. This escrow was dated December 18, 1928, and is identified as U. S. Exhibit 52. (R. 280-1.) With respect to this matter defendant Brown testified:

> "We also received instructions from McKeon Drilling Company to deliver stock to Frederick Vincent & Company and that is the stock that was placed in the escrow with the Bank of America. The purpose of the escrow in the bank was this: we had them put their partially paid accounts in there for subscriptions, written subscriptions, with instructions to the bank to deliver only to the subscribers thereof upon completion of the partial payment. The reason for it was the great lack of faith in Vincent by their particular associate brokers. The purpose of the creation of the escrow was to see that the people who were paying for their stock actually received it and the stock was furnished by the McKeon Drilling Company from the stock in escrow with Shingle, Brown & Company." (R. 1003.)

The escrowed stock aggregated 353,710 shares, was supplied out of the McKeon Drilling Company stock deposited in escrow with Shingle, Brown & Company and is shown by items 13, 18, 36, 43 and 48 of U. S. Exhibit 297. (R. 595-7.)

This escrow terminated on February 1, 1929. On February 4, 1929, the bank sent a check (U. S. Exhibit 55) dated February 4, 1929, to Shingle, Brown & Company, payable to its order for $100,489, representing the balance due from the subscribers who had partially paid for their stock. (R. 1003.)

Formation of broker's pool.

After the McKeon brothers had finally concluded to stand by the Italo Corporation and assist in consummating the merger and getting the company on its feet, and it had likewise been agreed that Vincent would have to be eliminated from the enterprise, it was realized by John McKeon and Wilkes that the syndicate would have to quickly dispose of its stock, in order to provide funds for the requirements of the Italo Corporation. This subject was discussed in a conference between John McKeon, Wilkes and the defendant Brown. The effect of such conversation, according to Brown, was as follows:

> "Jack said, 'Now, look here, I have taken off my coat and I have put my name on $600,000 worth of paper. I am going forward in this deal now and our properties are going in. * * * I am going to take off my coat and it is about time you fellows took off your coats now and went forward and pulled this thing out. You have got

to help'. He said, 'As far as the McKeon properties are concerned you can depend upon them going in'. That he had talked to Bob about this thing, that it was moving forward, and he wanted this thing to go into an oil company and he thought it would into a big one. He also said, 'You have also had an opportunity now to see how this situation was getting together. For the first time we have been given a financial statement of the company of its earnings. We have been shown the compilation of Abel and the various appraisers'. He said, 'I think you will see that it is good enough for you to interest yourselves in and your friends'. And asked us if we couldn't interest a group of reputable brokers in this concern enough to pull it through. Incidentally, he said if we can do it, he would see that we were not sorry for it." (R. 986.)

Upon Brown's return to San Francisco and after a conference with Shingle, the latter took up with a group of the leading and most reputable brokers in San Francisco and Los Angeles, the proposition of organizing a broker's pool through which to sell sufficient Italo stock belonging to the syndicate, to enable it to meet the requirements of its agreement with Italo. (R. 911; 913; 989.) In discussing the matter with Shingle, Wilkes said (according to Brown):

> "he would see that we were substantially rewarded somewhere along the line for our services if we could pull this thing through." (R. 989.)

In the early part of October, 1928, representatives from some of the San Francisco brokerage firms, a

representative of Graham, Atkinson & Company of Los Angeles, and Mr. Shingle, had a conference with John McKeon about the general affairs of the company. (R. 911-12.) The brokers were of the opinion that the Italo Corporation should have a more experienced management and insisted that before going into the deal John McKeon should head the company. (R. 912.) McKeon, however, stated that it was impossible for him to do so at that time because of his obligations to the Richfield Oil Company with which he was then associated, but he gave his promise that as soon as he could sever his connection with the company he would do so.

> "Because his heart was in this combination and he was going to devote his time exclusively to that, but in the meantime he would get a very good man to head the company, and he suggested or asked us if we would be satisfied with William Lacy of Los Angeles." (R. 912.)

In order, as far as possible, to keep any large offerings of stock from being placed on the market while the brokers were marketing the stock which was the subject matter of the pool, the brokers requested that the McKeon Drilling Company stock be placed in escrow. (R. 993; 915.) As the result of a subsequent discussion between Brown and John and Robert McKeon in Los Angeles the escrow was readily agreed to by the McKeons. (R. 993.) Thereupon all of the stock owned by the McKeon Company, excepting 60,500 units which had been sold to International Securities Company, was deposited with Shingle, Brown

& Company in escrow for ninety days. (R. 993; 918.) The escrow instructions were identified as U. S. Exhibit 98, its express purpose according to the escrow letter being

> "The protection of the market operation in which you (Shingle, Brown & Co.) are engaged." (R. 328-9.)

As a result of the suggestion made by John McKeon that William Lacey be made president of the Italo Corporation, an investigation was pursued by the brokers who ascertained that he was a man of high standing in Los Angeles, that he had been president of the Chamber of Commerce, head of the Community Chest, chief executive of the Lacy Manufacturing Company, was then a director of the Farmers and Merchants Bank, and had been experienced in the oil business. (R. 912.)

Thereupon John McKeon was commissioned to confer with Mr. Lacy, which he did, resulting in Mr. Lacy's acceptance of the presidency of the company. (R. 912.) Lacy insisted that he be given an option to purchase some stock and thus become financially interested in the company which he was to head, and not desiring to carry the load alone, likewise insisted upon having the right to put on the directorate some of his closest associates in the bank. Mr. Lacey was elected president of the Italo Petroleum Corporation on October 16, 1928, and upon his insistence Hugh Stewart, Fred E. Keeler, Frank B. Chapin, R. R. McLachlen and George McNear, all men of recognized integrity and outstanding business capacity, were

made directors. Mr. Lacy was also given an option by the syndicate on 100,000 shares of common stock at $1.00 per share. (R. 913.)

Illustrating the condition of Italo at this time and the enthusiasm of Mr. Lacy respecting its future, the testimony of the defendant Brown is illuminating:

> "About the middle of October, 1928, when Mr. Lacy and the other members of the Board of directors were elected, I had and was receiving statements of the auditors, including the earnings of the properties. I had a long talk with Mr. Lacy in San Francisco on October 16th, the day he was inducted into office as president, and he was highly enthusiastic over the situation. He stated he had made an investigation of the company on his own account, and likewise Fred Gordon, who was a vice-president of the company and formerly vice-president of the California Petroleum Company. The picture was about this: The company, according to the statement of the auditors of the properties they were acquiring, were earning about $354,000 a month in July; they had a production of thirteen to fourteen thousand barrels of oil a day, practically all light oil, in the Los Angeles Basin, and some in the San Joaquin Valley. They seemed to have assurance of good management through Mr. Lacy. In addition to this it looked like an extremely interesting speculative picture for the development of an oil company of considerable size. As a matter of fact, I think at that time it was the ninth, tenth or eleventh in size in California as a producer of oil." (R. 998-9.)

The members of the broker's pool were given an option on 2,500,000 shares of common stock at various prices. (R. 913.)

The operation of the broker's pool was highly successful and resulted in the sale of the stock. Within a period of two months after the pool was formed, from the proceeds of the sale of this stock and the moneys subscribed by the members of the syndicate, the syndicate was able to pay to the Italo Corporation the balance of the moneys due it from the syndicate, thus permitting the company to use these funds in the purchase of its properties. (R. 993-4.)

The basic reason for the formation of the pools is concisely stated by Mr. Brown, his testimony being:

> "In fact, the officers of the Italo Company insisted that we try to form the pool in order to save the situation." (R. 995.)

McKeon subscription to big syndicate.

The members of the big syndicate collectively subscribed $1,911,375, all of which, with the proceeds of the sale of the stock sold by it, were paid to the Italo Corporation. Of this sum John McKeon, on behalf of the McKeon Drilling Company, subscribed in the aggregate $300,000. With respect to these subscriptions John McKeon testified:

> "I went into the big syndicate by which the syndicate acquired 3,000,000 units of stock for $3,500,000 and was a subscriber and subscribed $300,000 thereto. My first subscription was $100,000 in the latter part of July, and then I subscribed $100,000 in the name of Art Delaney to

whom I owed $100,000, and he agreed to accept the membership in the syndicate for the $100,000. I put the money into the syndicate because I believed it needed it. I subscribed another $100,000 in the name of Mr. Siens who was doing a good deal of work getting members and getting money into the syndicate. It was at a time when we depended entirely upon the syndicate to raise the money necessary, and I felt by putting a subscription in his name it would be an aid to me in inducing other people in putting money.

When it came up to October 15th and our properties were to go into the company and we would not put them in without a $500,000 payment, it became necessary for me to accept two more memberships and 200,000 more into the syndicate to make it feasible to put the properties into the Italo Company whereby the Italo Company would begin to get the benefits of the production which at that time was 125,000 a month, but to complete the consolidation and get the thing going our properties had to go in. For that reason I took the other 200,000 subscription, first, to get the properties in and get the thing completed, and, second, to make a profit or a loss, whichever it would turn out to be. I had no other connection with the syndicate." (R. 1222-3.)

Showing his confidence in the project and his desire to assist the Italo Corporation John McKeon persuaded a number of his friends to subscribe to the syndicate, his testimony upon this subject being:

"I knew that the life of the Italo depended entirely on the syndicate and I got a great many of my friends to subscribe to the syndicate." (R. 1228.)

Conclusion of big syndicate.

By December 20, 1928, the receipts from stock sales made by the syndicate, plus the amount of money from subscribers to the syndicate, were sufficient to pay for the properties, the payments had been completed and an accounting was had with the Italo Corporation and with Maurice Myers, trustee of the stock.

On December 20, 1928, the Italo Corporation, Maurice C. Myers, trustee, executed an instrument stating that Shingle and Shingle, Brown & Company had complied with all their obligations as syndicate manager and escrow holders. (U. S. Exhibits 83 and 84.) These documents ended the transaction so far as Italo and Myers, as trustee, were concerned. (R. 917.)

As between the syndicate manager and the subscribers the syndicate was extended for six months from and after January 12, 1929. At the end of the time limit the syndicate stock that remained unsold was distributed pro rata to the syndicate subscribers according to their ownership therein instead of being sold. The syndicate had forty odd thousand dollars of notes of the Italo Corporation paid in lieu of transfer stock dividend which was escrowed with Farmers & Merchants Bank of Los Angeles, with authority to collect and distribute the funds to the members. None of these notes had been paid. (R. 927.) The result to the subscribers of the big syndicate is thus described by Mr. Shingle:

> "When the so-called big syndicate was organized the price was agreed upon at $1.16⅔ a unit,

a unit consisting of a share of preferred and a share of common. That price was agreed to by the syndicate, leaving a margin so that when it was raised there would be a profit. At least a profit was expected. No one would come into a syndicate of any kind unless they expected to make a profit. As a matter of fact, what developed was this: When that syndicate was formed in the summer and early fall of 1928, if we had sold all the stock to Vincent & Company the most profit any of the syndicate members could have possibly made was around fifty or sixty per cent. As it turned out, if they had gone out in January, 1930, and sold their stock at the prevailing market there would be a loss of about 25%, but as it is, anybody who still held their stock would have had a loss of 48%. There was 52% paid back in cash." (R. 928-9.)

It will thus be seen that instead of being profitable, the big syndicate resulted in a very heavy loss to its members, including John McKeon. While it was naturally anticipated that a substantial profit would be made by the syndicate members (R. 929) as a matter of fact they actually lost 48% of their investment, the amount paid to them in cash upon the termination of the syndicate being but 52% of their subscription. The notes of the Italo Corporation which the syndicate had in its possession representing some dividends upon the stock were never collected (R. 927) and the shares of preferred stock which had not been sold and were distributed among its members at the termination of the syndicate were not of any consequential value.

McKeon voluntarily restores to Italo $125,000 loss on Seaton community lease.

During or about the month of May, 1928, and before any negotiations had occurred between the Italo Corporation and the McKeons for the purchase of the McKeon properties, to which reference will be made later, Wilkes informed Robert McKeon that he was looking around for some properties to buy in Signal Hill for the purpose of developing them and wanted to know if he knew anything that was available. At this time the McKeon Drilling Company was drilling a number of wells in Signal Hill. McKeon called his attention to the Seaton Community lease and offered to sell him a half interest for $125,000 with the understanding that the McKeon Drilling Company would complete the well, furnishing everything necessary thereto; that thereafter each would own a half interest in the well and in the acreage under lease, and that all subsequent wells would have to be developed on a 50/50 basis. (R. 1121.) This well was subsequently drilled, but when a depth was reached from which production could be expected, there was no production, and it was deemed advisable to abandon the well. (R. 1122.) This opinion was subsequently confirmed by the geologist appointed by the executive committee of the Italo Company to investigate and report. Because of the failure of this well and to assist Italo financially, the McKeons voluntarily restored to Italo the consideration paid for it, relinquishing the property to the original owners and personally assuming the cost of the well. This was

done through the sale of 100,506 shares of the common stock received by McKeon Drilling Company for its properties and is shown in the summary prepared by Goshorn, U. S. Ex. 297, p. 595, item 9. Respecting this transaction, Robert McKeon testified:

> "That is the transaction referred to in the minutes in which I was thanked by the board of directors of the executive committee for my generosity in regard thereto." (R. 1123.)

This transaction is further shown by letter dated November 21, 1928, written by McKeon Drilling Company to Shingle, Brown & Company directing it to sell sufficient stock to net the Italo Company (U. S. Ex. 103, R. 120), and letter dated December 12, 1928, addressed to John McKeon for McKeon Drilling Company to Shingle, Brown and Company. (U. S. Ex. 105, R. 331-2.)

$300,000 loan to Italo.

In April, 1929, the Italo Corporation again found itself in dire need of a substantial amount of cash. The monthly payments upon some of its properties, including the payment of $160,000 to the Graham-Loftus Company, were falling due, and provisions had to be made for the monthly payment of its current obligations including those arising from their drilling operations which were quite extensive. (R. 1165.) The company owed the Farmers & Merchants Bank approximately $700,000, $250,000 of which had been guaranteed by John McKeon and others, which loan could not be increased. (R. 1165.) It was imperative,

therefore, that in order to take care of these necessities it procure an additional loan of $300,000. Unless this was forthcoming it is obvious that the company would meet with disaster.

Through the efforts of John McKeon the required $300,000 was loaned by a group consisting of McKeon Drilling Company, which loaned $50,000, Shingle, Brown & Company which loaned $25,000, and the following directors of the Italo Corporation who contributed $25,000 each, viz., Mr. Stewart, Mr. Gordon, Mr. Wilkes, Mr. Masoni, Mr. Perata, Mr. Siens and Mr. DeMaria. The money was turned over to the Italo Corporation and utilized for the above purposes. (R. 1165.) Although it was agreed that the loan should be repaid in ninety days, when the due date arrived this was found to be impossible. At this time the company was further embarrassed by the demands of the Farmers & Merchants Bank for payment of the indebtedness due it. (R. 1165.)

McKeon's surrender of its property security to assist Italo Corporation.

We have just shown that the Italo Corporation was unable to liquidate when due the $300,000 loan made to it by the McKeon Drilling Company, Shingle, Brown & Company, and its directors. We have also pointed out that the Farmers & Merchants Bank was pressing the Italo Corporation for payment of the indebtedness due to it. (R. 1165.) At this time the Italo Petroleum Corporation was endeavoring to negotiate a $3,000,000 loan, to be spread out on a bond issue or some other comparable character of security,

which would not require such large monthly payments. (R. 1165.) There was also an indebtedness aggregating approximately $190,000 due to Buck and Stoddard that was past due, and it was pressing for payment. (R. 1167.) For a number of months the McKeon Drilling Company had received no payment on account of the notes executed to it by the Italo Corporation representing a part of the purchase price of its properties, the unpaid amount of which approximated $400,000. Some of the group that had loaned the Italo Corporation the $300,000 were reluctant about renewing the note. (R. 1166.)

The unpaid portion of the purchase price of the McKeon Drilling Company's property due to it from the Italo Corporation was secured by the property. In other words, unless this indebtedness was paid, the McKeon Drilling Company could have regained possession of its properties. (R. 1166.)

Although the loan to the Farmers & Merchants Bank had been guaranteed to the extent of $250,000 by John McKeon, Masoni, Perata, De Maria and Rolandelli, the last four of whom were directors of the Italo Corporation, the bank was very much concerned because of the position of the McKeon Drilling Company with respect to its properties, and likewise the property of the Graham-Loftus Company, the stock of which secured the payment of the balance of the indebtedness due to its stockholders. (R. 1166.) It was quite apparent that unless this situation could be relieved in some measure the Italo Corporation would suffer a substantial financial loss.

To afford such relief the McKeons again went to the rescue of the company. John McKeon proposed that if the group that had loaned the $300,000 would renew its note for ninety days, and if the Farmers & Merchants Bank would do likewise with respect to the indebtedness due to it, the McKeon Drilling Company would deed its properties to the Italo Corporation, take unsecured notes for the unpaid portion of the purchase price, and would agree that no payments need be made by the Italo Corporation upon said notes until after January 1, 1930. (R. 1166.) He further proposed that if a bond issue or a refunding plan could be worked out, and made effective, the McKeon Drilling Company would take bonds in lieu of its notes, and thus save the underwriting of the bonds to that extent. (R. 1166.)

McKeon Co. releases its securities on Italo note.

As a result of John McKeon's efforts the plan proposed by him was acquiesced in by all concerned. In July, 1929, the McKeon Company transferred without limitation all of its properties, both real and personal, to the Italo Corporation, releasing all of its security and taking by way of substitution only the latter's unsecured notes. Because of and in consideration of the action thus taken by McKeon, the loans above mentioned were extended as required, and the Italo Corporation was able to take care of its current obligations and proceed with the development of its properties. (R. 1167.)

McKeon's guaranty of Buck-Stoddard indebtedness.

Not only was this action taken by the McKeon Company, but in addition thereto, it guaranteed the indebtedness of the Italo Company due to Buck & Stoddard in the amount of $190,000, and thus obtained a further extension of time for its payment. (R. 1167.)

In explaining the reasons for the action thus taken by the McKeon Drilling Company, and its members, Robert McKeon testified:

> "The reasons prompting me in foregoing our lien or claim upon the property at the time that I did were these: I considered the notes eventually would be paid, whether secured or otherwise. I considered that the assets of company were perfectly good and I could really see the objection of the other unsecured creditors to my position as being totally secured. I felt that if we could forego any insistent payment of those at that time that, within a few months the Italo would be well able to take care of all of its current indebtedness, if it could just get by without anybody insisting upon payment, and for that reason I gave up this security. I thought it would be a help to the company, but I really did not think I was giving up anything, because I thought the notes were good. Buck & Stoddard had been carrying the $190,000 account and it had been gradually growing. They had gotten some payments along the line, but the account had been gradually growing, and they had their account at the Farmers & Merchants Bank. That is where they carried the Italo notes, and the bank was pressing them a bit for that. They said they were

getting pretty full of Italo paper, and the McKeon Drilling Company had traded with Buck & Stoddard for many years, bought millions of dollars worth of goods from them in times past, and I realized that this extensive credit had been given by Buck & Stoddard to the Italo a good deal on account of my connection with the Italo, and I felt the Italo was perfectly responsible for the notes and we endorsed or guaranteed that paper to enable Buck & Stoddard to continue to carry it at the bank and make a new deal for everybody. I thought that the guaranteeing of the indebtedness of the Italo Company to Buck & Stoddard would help the Italo Company, and that was my purpose in doing that." (R. 1168-9.)

Italo sustained by financial assistance and cooperation of McKeons.

We have already commented upon the disastrous effect of the world-wide economic depression, as well as the over-production of oil and its resultant curtailment, which first made itself manifest during or about the latter part of 1929. This situation is one of which this court will take judicial notice, although the evidence bearing upon the subject was not attempted to be disputed.

Briefly stated, this evidence disclosed that from October 15 to December 15, 1928, the net income derived from the McKeon properties amounted to $246,-176.41 and the net income for the calendar year 1929 was $954,572.49. (R. 850.) It was also shown that if it had not been for curtailment the McKeon properties, after making a deduction of 10% for depletion,

would have produced at least $100,000 a month, or in excess of $5,000,000 between October 15, 1928, and May 31, 1933. (R. 850-1.) According to Ralph Arnold, if curtailment had not occurred the Italo Corporation would have made a profit of three or four times the profit made by it during such period. (R. 784-5.) The approximate percentage of curtailment is disclosed by the testimony of Raymond A. Earle, to which reference has already been made. (R. 847-8.) Upon this subject we invite the court's attention to pages 63 to 67 of this brief.

It is obvious, therefore, that the financial dilemma in which the Italo Corporation found itself was directly caused by the conditions just described, and that if normalcy in the oil industry had continued the Italo Corporation would have been one of the prosperous oil companies of California.

In April, 1929, Robert McKeon took over the management of the properties and production of the Italo Corporation and remained in such management until December, 1930. (R. 1170.)

Immediately upon becoming manager he made a report of the company's affairs to the board of directors which was spread upon its minutes. This report was made on May 14, 1929, and appears at the beginning of page 246 of Exhibit 16B. (R. 1179.) According to Robert McKeon's testimony:

> "I made that report a few weeks after I became general manager of the company, for the purpose of informing the board of directors of the situation of Italo as I saw it at that time as

to its properties and financial condition, and to the best of my knowledge and belief it is a correct report of the actual condition of the company at that time."

John McKeon resigns $100,000 position to aid Italo.

During January, 1929, although increased compensation was offered him, John McKeon resigned his position as manager of production of the Richfield Oil Company and thereafter devoted his entire time towards assisting the Italo Corporation. (R. 1218.) Upon this subject John McKeon testified:

"When Mr. Lacy came into the company I gave my resignation to the Richfield to take effect December 1st. They prevailed upon me to stay till January 1st to get matters straightened out. They did not want me to leave and would have been glad if I had stayed and offered me an inducement of increase in pay if I would stay, but I couldn't stay. I had the proposition started that was rapidly falling on my shoulders, and had agreed with Mr. Lacy I would come into the company." (R. 1218.)

Italo, through Robert McKeon, pays other creditors in preference to McKeon Drilling Co.

Between April, 1929, and December, 1930, while managing the Italo properties, Robert McKeon arranged for and brought about the payment of approximately $2,000,000 of indebtedness due by the Italo Corporation to various creditors. (R. 1170.) This indebtedness was paid by him notwithstanding

the fact that during the same period the Italo Corporation was indebted to the McKeon Drilling Company in an amount approximating $350,000 or $400,000 of which only $12,000 had been paid. (R. 1170.) The subordination of the indebtedness due to the McKeon Company to that due to the other creditors of the Italo Corporation was for the purpose of assisting the Italo Corporation, regardless of the effect of such assistance upon the McKeon Company. (R. 1170-1.) This is clearly shown by the testimony of Robert McKeon in which he said:

> "The other creditors of the Italo were paid in preference to the McKeon Drilling Company being paid at my direction because I had full confidence in the ultimate receipt of the money and I could always use that as an argument to other creditors when they began getting insistent, by saying, 'Here I am; I am sitting back and not paying myself a dollar, really, to help carry the credit of the company along'. My purpose in doing that was to help the company and not to harm it and I believed the company would eventually work out." (R. 1171.)

During the period above mentioned the McKeon Drilling Company, in order to meet its own financial obligations, had been compelled to procure bank loans, the repayment of which were secured by the Italo Corporation notes in its possession, representing part of the purchase price of its properties, as well as by the contract existing between the Italo Corporation and the McKeon Company. (R. 1171.)

Robert McKeon becomes owner of Italo notes to McKeon Drilling Co.

In January, 1930, the Italo Corporation was indebted to the McKeon Company in a sum between $350,000 and $400,000. At that time some of the McKeon brothers, particularly Raleigh, were insisting upon the payment of some of this indebtedness. Raleigh complained:

> "here they have had our properties now for more than a year. The properties have produced a lot of oil and lots of money and we have never been paid: everybody else has been paid, and it is about time that we began to look out for ourselves a little and collect this money." (R. 1169.)

Robert McKeon took the position, however, that it was impossible for the Italo at that time to make any payment and offered to trade to them his interest in the McKeon Company for outstanding notes of the Italo Company, his testimony being:

> "After some discussion I said, 'They can't pay it; it is impossible for them to pay it at this time, but I will make you this proposition; I am right in the middle of the Italo situation and know they can't pay, but I know that if they have time to work out their situation they will be able to pay all their bills and it will be really a successful company. I still have hopes of being able to finance or find a loan somewhere to fund those indebtednesses. We have reduced the indebtedness considerably under $3,000,000. I will tell you what I will do. I will take the Italo paper and will trade you my interest in the drilling company for that'." (R. 1169-1170.)

The proposal was agreed to and effectuated. Since that transaction, which occurred in February, 1930, Robert McKeon has been the owner of the indebtedness but has no longer been a stockholder of the McKeon Drilling Company. (R. 1170.) This indebtedness is still unpaid and outstanding. (R. 1195.)

Proposed organization of McKeon Oil Co.

It will be remembered that when Mr. Wilkes visited the east with the idea in mind of interesting some of his former associates in the so-called big syndicate he was informed that the enterprise was not of sufficient magnitude to warrant their interest, considering the expense to which they would be put in making the necessary investigations, but that if a larger organization could be effected they undoubtedly would become interested. (R. 723.)

It will also be remembered that a commitment had been obtained from John McKeon that as quickly as he could obtain his release from the Richfield Oil Company, where he was employed, he would take the management of the Italo Corporation's properties which at that time included the group of properties formerly belonging to the McKeon Drilling Company.

After Mr. Lacy took active charge of the company an extensive drilling program was initiated which involved the operation of twelve to fourteen strings of tools, requiring a considerable expenditure. The properties that were taken into the consolidation were merged subject to an indebtedness of $2,750,000. The monthly payments due to the former owners of these

properties aggregated $50,000 a month. These payments, together with the cost of development, were in excess of the Italo's monthly income which at that time was approximately $350,000. (R. 1217.) It quickly became apparent that the Italo Corporation was underfinanced and that although it had secured splendid oil properties it lacked available working capital. Furthermore, as frequently happens, the drilling program was not as successful as contemplated, and there was considerable disappointment in the work being done. (R. 1217.)

McKeons authorize use of their stock to assist Italo.

This state of affairs had already become apparent to John McKeon because at the time the Vincent contract was cancelled and the broker's pool brought into existence, mention of it was made to his brother Robert, whose testimony upon this subject was:

> "He (John) said the company was not properly financed and a large amount of current monthly payments, totaling a quarter of a million dollars falling due, and that that was a big load to carry; he said that until the payments were all made the properties, the main properties of the company were in jeopardy, and that Wilkes had come back from New York and had found bankers there that were very anxious to finance a large production company on the coast, provided they could get the right personnel in it, and the right kind of properties, and that they were perfectly willing to put this money behind him if he would head the company. Jack said his plan was to

> do that and that in order to do it we would have to have some money or some means to swing it. He would have to option some of the properties and he would need money to get it started until the backers could be in a position where they could underwrite whatever money was needed, so we agreed with him that he should use what of our stock would be necessary for that purpose. By that I mean that Raleigh and I agreed with Jack that Jack could use the stock of the McKeon Drilling Company which it was to receive from the Italo Company as part payment for its properties." (R. 1144.)

This situation resulted in a number of discussions between Wilkes and John McKeon, having in mind the possible reorganization of the Italo Corporation, changing the par value of its stock, acquiring additional oil properties, raising sufficient funds to enable payment in full of the outstanding indebtedness of the Italo Corporation, paying for properties to be acquired and having on hand sufficient available funds to enable it to proceed with its development work. It was also proposed that this financing should be done through New York bankers. (R. 735.)

These conferences, together with the financial situation that had developed, persuaded Wilkes and John McKeon that reorganization was imperative, and the understanding was reached between them that upon the latter leaving the Richfield Company and taking charge of the Italo Company's properties, Wilkes was to step out of the company and devote his entire time and attention to the proposed reorganization.

(R. 735.) Upon this subject defendant Brown testified:

> "Shortly after October 15th when the company had been put in shape, Mr. Wilkes said he was going to devote practically his entire time from that time on to develop a larger picture with Jack McKeon who intended to get away from the Richfield and was going to take charge of the company; that they wanted to form a large company which would be interesting to the Eastern bankers." (R. 999.)

Eastern capital becomes interested in proposed consolidation.

Information respecting this proposed reorganization was conveyed to both Mr. Shingle (R. 918) and defendant Brown. (R. 995.) With the suggested reorganization in view Wilkes communicated with the group of New York bankers with whom he had previously conferred with respect to the original financing of the Italo Corporation, and early in November, 1928, a Mr. De Shadney, a representative of Palmer & Company, arrived in California for the purpose of making the preliminary investigations and giving consideration to the proposal on behalf of his principals. (R. 735; 918; 999.) After his arrival meetings were arranged between Mr. De Shadney, Wilkes, McKeon, Shingle and Brown. The character of Mr. De Shadney's mission was explained by him to the defendant Brown who testified:

> "Early in November, 1928. I met Mr. De Shadney, the representative of the eastern banking group. Mr. De Shadney was connected very

closely with Palmer & Company, a member of the New York Stock Exchange, and he informed me substantially as follows: That the eastern crowd was very much interested in financing a large producing company in the west headed by Mr. McKeon, if the properties could be gotten together in proper shape, to make a large picture for them, that they would be very much interested. It would probably involve financing in a very large amount, maybe a total of twenty to thirty million dollars, handled with a good-sized bond issue as a foundation and the rest would be handled by them as a stock matter. Both Mr. De Shadney and Mr. Wilkes, who were experienced in eastern financing, indicated to us that in order to put over a big issue in New York it would be important that they have coast distribution of it; that is always true, by the way, of eastern financing of western matters, that the local market should take a reasonable amount of the financing." (R. 999-1000.)

According to Mr. Shingle:

"In November a representative of the eastern brokers came out to San Francisco and they wanted to know if we could meet him and if the figures were all right on this new deal if we would join with the eastern brokers in helping out on the deal, so we asked them what the tentative plans were and it was to be a bond finance and a stock finance, and we told them that we would be very much interested in carrying our share of the bonds." (R. 918.)

De Shadney remained in this vicinity for about a month by which time plans were practically completed

to go ahead with the reorganization. (R. 736.) During this period communications were constantly passed between De Shadney and his eastern principals. (R. 1000.) Shortly after De Shadney left for the east he returned with a lawyer named Lyons and an accountant. (R. 736.) Lyons explained that the firm of O'Melveny, Tuller & Myers had been employed by them to look over the details and that they expected a report within a very short time. Also that Mr. Moran had been or was to be employed to make up to date the appraisements of all the properties they had under consideration including those belonging to the Italo. (R. 921.) Both Lyons and De Shadney said that they expected the deal to be consummated during the latter part of February. (R. 921.)

Options obtained for benefit of proposed consolidation.

While De Shadney, and subsequently De Shadney and Lyons were in California, a number of proven oil properties were examined and negotiations undertaken for their acquisition. As a result of these negotiations options were obtained covering the Wilshire Oil Company properties, the Dabney-Johnson properties, the Delaney properties at Signal Hill and the O'Donnell properties. (R. 736-7.)

The activity of John McKeon in connection with this proposed reorganization, as well as the financial assistance rendered by him in order to secure options and get together available oil properties for the proposed reorganization is aptly described by him:

"I told him (Wilkes) * * * that I would use what stock was necessary to put the properties together and finance the deal that we were then working on. It took a good deal of money to do that. In order to get this together we had to have positive options and deeds on our properties, and we took several properties over and paid substantial amounts on them." (R. 1221.)

Expenses of and options procured for consolidation paid by John McKeon.

That all expenses incurred in the attempted consolidation were assumed and paid by John McKeon personally, and that all moneys used in obtaining options upon properties intended to be acquired for the proposed consolidation were paid by John McKeon is also shown by his testimony:

"I furnished all the money that was used in that attempted consolidation. There wasn't a dollar ever charged to the Italo on it, and it ran in all before I got through between $400,000 and $500,000, nearer $500,000 than $400,000 I believe. We paid Mr. Dabney $250,000 for his option and a partial payment on his properties. That was paid in form of a note which I secured with 1,000,000 shares of Italo stock which was part of the 4,500,000 shares of stock the property of the McKeon Drilling Company. That was common stock. I never got any of that stock back." (R. 1221-2.)

"In the deal I was able to hold the properties until way into the next summer without any further payments. I got extensions and kept Dabney from selling any of the stock to reimburse himself,

by giving him a mortgage on a very beautiful home I had, and I got further extensions by adding further security, and in the windup I lost the stock and lost the home and I paid Dabney, I think, $50,000 in cash besides. The property that all of this money was paid on was the property that I was optioning for the purpose of carrying out the reorganization of Italo and development of the so-called big company that was planned." (R. 1222.)

Upon the same subject John McKeon further testified:

"We looked at a great many properties and decided upon the Dabney and Johnson properties. That was a very big company and had a big production. We had an option on it for $6,000,000 in cash; it was a very good buy at that price. We had the properties of the Dabney Petroleum for a million and a half and we had the Jim O'Donnell properties that we were paying a million for. Those were the three groups of properties that we were going into with the Italo properties." (R. 1223.)

The deposit by John McKeon of 1,000,000 shares of common stock belonging to the McKeon Company as security for the Dabney-Johnson obligation is evidenced by a communication in writing dated February 16, 1929, sent by the McKeon Company to Shingle, Brown & Company, escrow holders of the stock. (U. S. Exhibit 114, R. 335.)

With respect to the Dabney option, to which reference has already been made, John McKeon executed

and delivered his note for $250,000 and as security for its payment put up a million shares of Italo stock belonging to the McKeon Drilling Company. (R. 1232.) These expenditures were likewise testified to by Wilkes, who stated:

> "The money that was spent by McKeon and myself on the reorganization of the Italo was all McKeon's money, although I was acting as his agent in handling it; when the final settlement came after the crash in the fall of 1929 it cost us over half a million dollars. A million shares were put up to secure the note to Dabney-Johnson, which were lost, and we had to pay a deficiency judgment of $250,000. Jack McKeon lost a ranch which cost him in the neighborhood of $100,000; there was $10,000 paid to Delaney, $10,000 paid to O'Donnell and, including the attorneys' fees, accountants' fees, engineer's fees and expenses and one thing and another it ran up in the neighborhood of half a million dollars. That money was derived from the sale of stock received by John McKeon which had been paid to the McKeon Drilling Company by the Italo Petroleum Corporation of America in payment of the properties of the McKeon Drilling Company." (R. 740-1.)

Set-up of proposed consolidation.

The proposed set-up of the new corporation which was to be called McKeon Oil Company, is shown in a wire that was sent by John McKeon to Palmer & Company in the early part of 1929 and is as follows:

> "Proposed McKeon Oil Company will include following properties, Italo Petroleum Company with present production of thirteen thousand barrels per day. Net earnings of company for

last quarter 1928 was $1,043,000. There are eleven wells drilling on this property which will be completed during next ninety days. Cost $17,500,000 stock, $2,500,000 cash.

Dabney Johnson properties present production 12,000 barrels. Earnings last quarter $1,015,000. Fourteen wells now drilling which will be completed during next ninety days to be paid for on basis of production after completion. Past present production $6,000,000 cash.

Delaney-Edwards-Campbell-O'Donnell properties present production 4500 per day. Past earning statement not available as to wells recently completed. Estimate earnings $125,000 per month. Cost $2,500,000 Cash $500,000 Stock. Two wells drilling.

McKeon Brothers properties. Present production 5000 barrels per day. Production too recent for earnings statement. Three wells drilling. Estimate earnings $100,000 per month. Cost $1,000,000 cash, $750,000 stock.

Arroyo Grande property comprises 2000 acres proven oil land with one well producing 350 barrels per day. One well now drilling. This includes also 600 acres lease at Rindge Ranch considered very valuable prospective field.

These properties not considered in earning class but necessary as future reserve, cost $1,000,000 cash, $1,000,000 stock. Engineers reports as yet not all completed but am assured will show between fifty and sixty million valuation of all properties. Total present production in excess of 34,000 barrels per day and present earnings at rate of over $10,000,000 per year. Total cash required $13,000,000 to which should be added

> $2,500,000 working capital. Total stock required $19,750,000. In order to handle proposition $400,000 must be paid down this week to hold certain properties. McKeon and associates are willing to furnish this cash but must know that bankers are ready to go ahead with proposition." (R. 1007-8.)

To acquire these properties, most of which had already been covered by options acquired by John McKeon, and thereby effectuate the proposed reorganization, considerable financing was essential. (R. 1223.) It was realized that in order that the reorganization should be successful, the Italo Corporation would have to be relieved from the immediate payment of substantial sums and sufficient working capital would have to be provided to enable its development to go forward without hindrance.

Plan for financing proposed consolidation.

With this plan in mind it was first proposed by the representative of the eastern group that if other properties could be added to the group already acquired, and provided a proper return could be assured, they would furnish $15,000,000 on a basis outlined by them. (R. 1218-19.) Upon this subject John McKeon testified:

> "The bankers were to furnish the $15,000,000, $10,000,000 of which was to be a bond issue and $5,000,000 to be raised from the sale of debentures which were a sort of bond that was transferable into stock at a certain price, and it was to be part of the agreement that the brokers on the coast would handle $5,000,000 of the bonds. We were

paying Dabney $6,000,000, Delaney a million and a half, and a million to O'Donnell, making a total of eight and a half million. Out of the $15,000,000 it would take about two and a half million to pay the debts of Italo which were to be paid, and that would leave us $5,000,000 working capital, which capital would have been used in developing our undeveloped properties and carrying on our work, and had that deal been consummated the Italo Company would have been a very splendid company, and would have made money for everybody concerned. That would have left four and a half million for working capital." (R. 1223-4.)

Later on, however, the plan was changed to a $10,000,000 bond issue (R. 918-9), upon the understanding that Shingle, Brown & Company would absorb $5,000,000 worth of the bonds. Upon this subject Shingle testified:

"Along in the latter part of October or the early part of November we first heard of Mr. John McKeon's plan for a larger oil company. I was told that when Wilkes was in the east, in the latter part of August or the first part of September, he had been working with eastern bankers at that time making plans for the formation of a larger company with the idea of continuing to buy some properties. This is the first time that we learned of this matter, and in November a representative of the eastern brokers came out to San Francisco and they wanted to know if we would meet him and if the figures were all right on this new deal, if we would join with the eastern brokers in helping out on the deal, so we asked them what the tentative plans were and it was to

be a bond finance, and then a stock finance, and we told them we would be very much interested in carrying out our share of the bonds.

The deal as they had it lined up at that time would take about $10,000,000 of bonds and I don't recall what was said about the stock, although there was considerable stock in addition to that. The entire deal, that is, the amount of all the properties involved would run about $30,000,000. Wilkes mentioned the acquisition of the properties of the Wilshire Oil Company, the Delaney properties and several others. He said the eastern houses were willing to take it up if it was big enough. Subsequently I met Mr. De Shadney, representing the eastern people. I met him in San Francisco in November, and Mr. Brown had some talks with him later on that month in Los Angeles. Mr. De Shadney said the bond issue would run about ten million dollars and that we would be expected to take half of the bond issue, or five million dollars in bonds." (R. 918-9.)

Under the plan all of the stock was to go to the Italo Corporation stockholders excepting 12½% which went to the eastern bankers who furnished the money. (R. 1224.) None of this stock, however, was to go to Shingle. Brown & Company, notwithstanding the fact that it had to underwrite or purchase half of the bond issue. As to this matter Shingle testified:

"They told us, but we knew that anyway, that any eastern house would very seldom or never finance a western bond issue without having western sponsors or western brokers, interested with them. We had a discussion with them relative to the $5,000,000 in bonds that we

> were expected to take and we were told very frankly that this was an eastern deal but we could be in on the bonds and they wanted us to be in on the bonds, but as far as the stock was concerned that was to be handled all to themselves. We knew what it meant; that is, that they had a stock bonus and didn't want to give us any part of it." (R. 919.)

This testimony was corroborated by defendant Brown, who in testifying to a conversation between himself and Lyons, said:

> "With respect to Shingle, Brown & Company receiving any portion of the stock bonus that was to be issued to the eastern bankers for financing the bond issue I told him I presumed the eastern bankers would want the stock bonus. I asked him if he would have any interest in that and he said no, that the eastern bankers would handle that entirely back there, that we could handle some of the bonds. We had already been compensated and I said we would do that to the limit of our ability." (R. 1010.)

At this time the firm of Shingle, Brown & Company was not in a financial position to carry half the $10,000,000 bond issue, and it was necessary for them to get their bank credit in shape to measure up to their commitment. Accordingly, during the early part of January, 1929, they proceeded to gradually and slowly sell the stock which they had obtained from the McKeons, to which reference will hereafter be made, to put themselves in proper financial position, the stock being sold at market. (R. 920-1.)

Company to be called John McKeon Oil Co.

To avoid localizing the new company it was suggested by Lyons that it be called the McKeon Oil Company after John McKeon who had "a big name throughout the country". (R. 740.) After Lyons had pursued such investigation as he deemed essential and before leaving for the east he stated that there was no question but that the deal would go through. Upon this subject defendant Brown testified:

> "Mr. Lyons had told me in the presence of Jack McKeon and A. G. Wilkes in Los Angeles that there was no question at all about the deal going through, and Jack McKeon was going east with him and it would be closed up very quickly." (R. 1010.)

This was Brown's opinion, who stated:

> "In March, 1929, I believed that the McKeon Oil Company, which was under discussion at that time, was a certainty to go through." (R. 1011.)

McKeon's New York efforts to consolidate.

About the 10th of February, 1929, John McKeon and Lyons went to New York, having arranged with Wilkes to have prepared auditor's reports and earnings reports covering the different companies whose properties were to be acquired. The eastern group then insisted upon obtaining an engineer's report upon the whole situation by Robert Moran, a well-known engineer, which was done. (R. 740; 1009-10.)

In April, 1929, defendant Brown was called east on business and while in New York conferred with John

McKeon. (R. 1010.) At this time McKeon, who had been in the east approximately two or three months, although disappointed at the delay, was still hopeful that the deal would be consummated. According to Brown's testimony:

> "Jack was still somewhat hopeful, but he had been back there two or three months. The deal was supposed to be closed every other week and he still had one matter to thresh out but he was considerably disappointed. The deal was almost closed two or three times with other large houses, but whether it was due to market conditions or otherwise I don't know. The deal wasn't quite closed. He told me that the deal at that time was coming down to be largely a stock matter, and I told him that I didn't think it could be successfully handled as such. The market was very heavy on new issues of stock, what is known as undigested securities. The dealers' shelves were pretty full and they weren't interested in new securities. We were coming very definitely to the big break in the latter part of the year. I told Mr. McKeon in the language of the street that I thought he had been getting the run-around back there. I also talked to Mr. Lyons of Palmer & Company, in the presence of Mr. McKeon. I asked him what was doing and he said he thought the deal was still all right and going through all right. He asked me if we wanted to handle half of it and I said, 'What is the deal about? I want all the details.' He said, 'Well, we are changing these things so that I am not prepared to give them to you.' I said, 'Well, I am leaving for the coast; send me the details and I will give you my answer.' Subsequent to that I came back to the coast." (R. 1010-11.)

As the result of the sale of the stock acquired by it, towards the end of February,—but at least by the middle of March, 1929,—Shingle, Brown & Company reached a position where it was able to take over the $5,000,000 of the $10,000,000 bond issue if the bonds had then been issued. (R. 922.) About this time, however, certain changes took place in the proposals of the eastern group respecting the character of the financial structure of the new company.

While theretofore the basis of the financing of the new organization, as proposed by the eastern group, was a bond issue, one-half of which Shingle, Brown & Company was in a position to absorb, they gradually turned the proposition into a stock deal, the bond issue being gradually eliminated. (R. 922-3.) This change of attitude on the part of the eastern group may have been merely a makeshift to enable its members to withdraw their financial support, because of conditions then making themselves manifest in the financial world, without making it appear that they were repudiating their commitments.

That it was practically impossible at this time to secure adequate financial assistance through stock issues is pointed out by the testimony of Shingle, when he states:

> "There was a financial condition that existed in the country in the spring of 1929 which was that you could still get good bank credit on bonds, but not on new stock issues, whereas probably six or eight or ten months before that you could finance new stock issues. All of the banks in San Francisco were gradually shutting down on listed

stocks on credit they would give to brokers, and it was absolutely impossible to get any credit, or any substantial credit at least, on any new stock issues. It was a forerunner of the market break that took place in the fall of that year. We could carry about $5,000,000 of bonds for probably 15% margin; that would take about $750,000 of our capital, and it meant that to handle $5,000,000 of stock we would have to put up the whole $5,000,000 because we couldn't borrow anything from the banks." (R. 923.)

The proposed "big deal" was in fact never effectuated and in the late summer of 1929 all negotiations came to an end. Its termination can readily be traced to the instability of financial conditions which finally ended in the still existing world-wide economic depression. (R. 923-6.)

We are now brought to the disposition made by John McKeon, with the consent of his brothers, of certain portions of the stock which was delivered to the McKeon Company in part payment of its properties and assets.

McKeon Company stock used for benefit of Italo Corporation.

As has already been stated, on July 5, 1928, an agreement was entered into between McKeon Drilling Company, Inc., and Italo Petroleum Corporation of America in which the Italo Corporation purchased from the McKeon Company certain of its property and assets for the sum of $5,500,000, of which $500,000 was to be paid in cash, $500,000 to be represented by ten promissory notes of $50,000 each, due monthly begin-

ning September 1, 1928 and 4,500,000 shares of its capital stock, of which not less than 2,000,000 should be common stock, the stock to be delivered within sixty days, and the entire agreement to be subject to the provisions of the Corporate Securities Act and the approval and consent of the Corporation Commissioner. (U. S. Exhibit 44, R. 305-6.)

After several verbal extensions, granted to Robert McKeon, to which reference has already been made a supplemental agreement was entered into on September 18, 1928, in which the McKeon Company acknowledged receipt of $250,000 on account of the initial $500,000 down payment, $100,000 of which was to be evidenced by the syndicate subscription of John McKeon. It further agreed that the Italo Corporation should have until November 15, 1928, to pay the balance of the $250,000 and agreed to accept the syndicate subscription obligation of Arthur Delaney up to $100,000 on account thereof. The McKeon Company also agreed to defer the delivery of the ten notes for $50,000 each until November 15, 1928, and gave the Italo Corporation six months from the payment of the balance of the down payment to pay the obligations assumed by it under its agreement. (R. 307.)

At the time Shingle arranged with the brokers to sell Italo stock on behalf of the big syndicate, it was understood that the McKeon Company stock should be escrowed in order to prevent it from being sold on the market and thus interfere with their sales. (R. 1150-1.) Accordingly, on October 26, 1928, the stock to which the McKeon Company was entitled was de-

livered to it by Maurice C. Myers, trustee (R. 328), and on the same date all of this stock, excepting 60,500 units which the McKeon Company had previously sold, were deposited in escrow with Shingle, Brown & Company:

> "to hold as an escrow so that none of said stock shall be sold or offered for sale for a period of 90 days, unless such escrow shall be sooner terminated by an agreement between yon and the undersigned." (U. S. Exhibit 98, pp. 328-9.)

The record clearly and convincingly established that until this escrow was completed, neither John McKeon, nor any member of his family, agreed to supply stock to anyone or for any purpose excepting to take care of the Vincent & Co. situation to indemnify Shingle, as syndicate manager, against the loss of any part of the two million shares of stock deposited as security for the loans obtained from the Farmers & Merchants Bank aggregating $600,000 and to compensate Shingle, Brown & Co. for services to be rendered by it in connection with the refinancing of Italo through brokers' pools, and otherwise. (R. 1238-9.)

We have also shown that when it appeared that there was a probability of the original merger collapsing because of the omissions and activities of Vincent & Company, and in order to save for Italo the properties upon which a substantial part of the purchase price had been paid, the McKeons used part of the stock belonging to them then held in escrow. We have likewise pointed out in the preceding pages of this statement the use by John McKeon, with the consent

of his brothers, of large blocks of this stock for the purpose of assisting in the financing of Italo, and likewise in obtaining options upon properties intended to go into the new consolidation and to meet the expenses connected therewith, all at a time when everyone interested in the Italo Corporation realized that due to conditions over which they had no control, it was underfinanced and in the absence of a further reorganization, which included the acquisition of additional properties as well as refinancing, the Italo Corporation and its stockholders would inevitably suffer disastrous financial loss.

We have likewise made manifest by reference to undisputed portions of the record, that neither at the time that the McKeon-Italo contract was negotiated or executed, nor at any time prior or subsequent thereto, was there any understanding, suggestion or intimation by anybody that in connection with the acquisition by the Italo Corporation of the property and assets of the McKeon Company any officer, director or other person interested in Italo should receive or participate in any part of the consideration which was demanded, or which would be paid by the Italo to the McKeon Company. (R. 759, 1173, 1207, 1230.)

On the contrary, it has been conclusively shown that it was only with the greatest reluctance that the McKeon brothers were finally persuaded to enter into the consolidation, and that it was only because of their desire to prevent injury to the Italo and to avoid financial loss to their friends who had joined the big

syndicate at their request, that they were prevailed upon not to withdraw from the consolidation and cancel their agreement, which course they had a legal right to pursue.

In order to appreciate the circumstances under which certain of the McKeon Company stock was some months later given to some of the directors and officers of the Italo Corporation, it is essential that the underlying facts be ascertained and understood, as to which there is no contradiction in the record. This is important because unless the transaction culminating in the purchase of the McKeon properties by Italo was tainted by some sinister promise, understanding or agreement to turn over to the officials and directors of the Italo a part of the consideration to be paid therefor, and that in fulfillment thereof, the stock subsequently given them was so transferred, no complaint can be legitimately made because of what the McKeon Company or its officials did with its stock after the transaction was consummated.

Until Wilkes in New York was unable to obtain financial assistance on behalf of Italo in connection with the original merger, due to the fact that the project was not of sufficient magnitude to persuade the intrusion of eastern capital, and until Vincent & Company failed completely in its commitments to the Italo and the syndicate and engaged in unauthorized activities with respect to stock sales, and until it was necessary for John McKeon to obligate himself and some of his friends to the Farmers & Merchants Bank to the extent of $600,000 and indemnify Shingle against the

loss of two million shares of stock, and supply the stock necessary to eliminate Vincent & Company, because the syndicate was believed to be without legal authority to itself furnish the stock, nothing occurred that would justify a subsequent challenging of the ownership of the McKeen Drilling Company stock. This outstanding fact, not contradicted or susceptible of contradiction, should be constantly kept in mind by the court, because it has an important bearing upon this phase of the pending controversy. When it was appreciated by John McKeen that unless $600,000 was raised at once, Italo would lose the Graham Loftus properties, upon the purchase price of which $250,000 had already been paid, he arranged for the necessary loan, indorsed the obligations and indemnified Shingle as syndicate merger to the extent of 2,000,000 shares of Italo stock. (R. 725, 906, 1209-1212.) When, due to the Vincent "debacle" the Italo was faced with collapse, and he was informed by Wilkes

> "that the company hadn't any way in the world of settling with Vincent; they had no stock, and if I didn't come to the rescue of the company at that time he was again in a very bad hole" (R. 1213).

he generously, with the consent of his brothers, supplied the necessary stock out of the drilling company's allotment and informed Shingle that he would compensate his firm for any services that it might render and any responsibility it might assume in assisting in further financing Italo. (R. 725, 911, 922.)

The brothers, however, protested against the use of the stock of their company for this purpose, and it was not until John McKeon had explained to them the urgency of supplying the stock and the necessity for reorganizing on a larger scale to save the project, that they finally acquiesced, the understanding being, however, that when reorganization and proper financing finally occurred, their loss would be restored. (R. 1, 144-5.) Surely generosity of this kind cannot be made the basis of or converted into a criminal conspiracy. It was only after these explanations had been made by John McKeon (R. 1141-4) that Robert and Raleigh McKeon agreed that

> "Jack could use the stock of McKeon Drilling Company which it was to receive from the Italo Company as part payment of its properties." (R. 1144.)

After Mr. Lacy had taken the presidency of the Italo Corporation, and at his request certain of his business associates had become directors

> "Our company took on a new aspect, the syndicate subscriptions rolled in, the sale of stock started big and there was plenty of money to pay all of the contract payments when they became due and it looked like it was a very feasible thing then to build a larger company out of Italo." (R. 1147.)

Under these circumstances, according to Robert McKeon:

> "Raleigh and I agreed with Jack that Jack could use up 2,500,000 shares of stock for that pur-

> pose. By 'that purpose' I mean to enlarge the Italo and make a bigger company out of it. We didn't know exactly how much it would take, but we told Jack that he could use the 2,500,000 shares; that we would be perfectly satisfied for our end of it if the McKeon Drilling Company retained 2,000,000 shares of stock and that he could use 2,500,000 shares for the purpose of enlarging Italo or for his own purposes. He had some affairs that he wanted to straighten up, some real estate interests, and it was our understanding that he was to have the stock to do with as he pleased for his own affairs and for the affairs of Italo, including the matter of dealing with Perata and Masoni, the Vincent settlement and anything else that he thought it was necessary to do." (R. 1147.)

That no one but the McKeon Company had any interest whatever in the stock is likewise testified to by John McKeon:

> "I considered that the McKeon Drilling Company owned that stock I agreed to distribute. The drilling company gave real value for the stock, all that it was worth, and nobody had anything to do with it. In my judgment at that time the stockholders of the Italo Petroleum Corporation of America had no remaining interest in that stock. They had value received for the stock they had given and had absolutely no interest in it whatever. I figured it was our property to do with as we pleased." (R. 1218.)

And as showing the circumstances under which his brothers finally agreed to his use of the stock, John McKeon further testified, on cross-examination:

"After the contract was executed I had a conversation with my brothers and discovered at that time that the financial condition of the Italo was not what it should be, and that we had to get behind it and help it out. At the first conference with my brothers they didn't say, 'You take 2,500,000 shares of stock for your own and do that with it', but at that conference we didn't decide on any number of shares of stock and didn't figure it would take anything like 2,500,000. There wasn't any agreement on that until after I had gone into my deal step by step and gotten rid of a great deal of my stock which was late in November or early in December. The first conversation with my brothers in which it was decided that I should use some of the McKeon stock for the purpose of getting behind the finances of the company was at that time. Also I was to use a part of that same stock to straighten out my real estate affairs and difficulties I had gotten into in San Bernardino and I needed some money. That was in November, 1928. It could have been the latter part of October or the first part of November, 1928. It was after October 26, 1928." (R. 1238.)

And still later:

"I considered that entire 2,500,000 shares of stock to have been transferred to me by my brothers for any use I wanted to put it to. I did not consider that I had to account for that stock to any person." (R. 1242.)

As has already appeared, the contemplated consolidation tentatively referred to as the McKeon Oil Company, for the reason indicated, was abandoned during

the late summer of 1929. Between the escrowing of the McKeon Drilling Company stock on October 16, 1928, and such abandonment, a considerable quantity of the stock of the McKeon Drilling Company had been delivered to a number of persons, some of whom were then or had been officers or directors of Italo. It is with the assignment of stock to these individuals alone that we are presently concerned, for the obvious reason that any transfer of stock to others would have no logical tendency of establishing any conspiracy to defraud Italo or its stockholders, by permitting secret profits to be gained by its officers or directors, though later in this statement, we will have occasion to refer to the stock assigned to Shingle, Brown & Company. Those coming within the category above mentioned, to whom stock was delivered by John McKeon are as follows: A. G. Wilkes, John M. Perata, Paul Masoni, E. B. Seins, Howard Shores, James B. Westbrook, John B. De Maria, Maurice E. Myers and Hugh Stewart.

Before showing the circumstances surrounding and persuading such assignments, we believe it proper to point out the office held by each of these parties in Italo, as well as the period during which such relationship existed. At the first meeting of the directors, held in Delaware on March 10, 1928, John M. Perata, Paul Masoni, F. V. Gordon, Robert McKeon and A. G. Wilkes were elected directors. (R. 236.)

On March 14, 1928, the directors for the first time met in California. The meeting was attended by John Perata, Paul Masoni and A. G. Wilkes, who were

elected president, secretary-treasurer and vice-president respectively. (R. 236-7.)

On May 28, 1928, the board of directors was supplemented by the addition of F. P. Tommasini, G. Rolandelli, John B. De Maria, Adam Bianchi, Oreste Matteucci, Harry L. Martini, Victor Pizzi, E. B. Siens, J. V. Westbrook, Howard Shores, James De Pauli, Henry Clausen, John Spigno and Albert Quilici. (R. 239-40.)

On October 16, 1928, directors Shores, Westbrook, Quilici, Clausen, Spigno, De Pauli and Tommasini, resigned and William Lacy, Fred E. Keeler, Frank B. Chapin, Hugh F. Stewart, Maurice C. Myers, R. R. McLachlen and George McNear were elected in their place. At the same meeting Perata resigned as president, and Lacy was elected in his stead. Thereupon John B. De Maria was elected second vice-president, and the newly elected president Lacy appointed William Lacy, F. V. Gordon, Robert McKeon, E. B. Seins, Maurice C. Myers, Paul Masoni, John M. Perata and A. G. Wilkes as the executive committee. (R. 245-6.)

Because of the importance of this phase of the case, as well as to subserve the convenience of the court, we will deal separately with each of the parties mentioned.

1. *A. G. Wilkes.* Wilkes became a director, vice-president and general manager of the Italo American Petroleum Company on November 20, 1927, and remained such until after its assets were transferred to the Italo Company. He became a director of the

Italo Company on March 10, 1928, and remained such until after the appointment of the receiver in December, 1930. (R. 236.) He acted as general manager of the company until April 18, 1929, when he resigned. (R. 251.) After the election of Lacy as president on October 16, 1928, he devoted his entire time and attention to the proposed consolidation. (R. 735, 999.)

From the time that it became evident that Italo was not sufficiently financed to enable it to meet the required payments upon the properties purchased by it, as well as the expenses arising out of the necessary development of its properties, until after the so-called contemplated merger, under the proposed name of McKeon Oil Company, came to an end in the summer of 1929, Wilkes, acting in cooperation with John McKeon, devoted practically all of his time in the investigation of oil properties and enterprises of considerable magnitude potentially adaptable for consolidation, obtaining reports upon these properties and assisting as far as he was able in obtaining finances for the use of Italo in order to conserve its properties and permit their development. During this period he not only traveled extensively over California but likewise made several trips to New York. These expenses as well as moneys paid by him as the representative of McKeon for options covering properties to be included in the proposed merger were derived from the sale of the stock belonging to the McKeon Drilling Company. On this subject John McKeon testified:

> "The fact that Mr. Lacy was going to continue with the company and that I was going to give the rest of my time—I felt it should be made a

bigger company and we felt that we should have or would have to have some refinancing of one kind or another, so Mr. Wilkes, whom I depended upon entirely in the matter of that kind, I wouldn't have gone into any financial or consolidation program without the assistance of Mr. Wilkes, in whose ability and integrity I had confidence, and with whom I had been for twenty years, and I felt he was the most capable and successful organizer and financier I had known of in the country and I don't think there is any other man I would have put as much behind as I would have put behind Mr. Wilkes. Therefore I depended upon Mr. Wilkes, so I told him about this time if we would make a bigger company, bigger operations, and get more money, providing he would stay with me and hold together the members of this company, which would be necessary, that we would attempt to make the company much larger and put it on a sound basis." (R. 1219.)

And after testifying that the conversation with respect to this matter with Wilkes and others occurred

"several months after the deal was made and it had nothing to do with it at all." (R. 1221.)

John McKeon proceeded:

"At that time I was working with Mr. Wilkes. He was the man I depended upon in working out our plans more than anybody else. I told him that if he would give up his attention entirely to the Italo and turn that over to my brother Bob and Lacy, let them handle that, and go to work on this deal, that I would use what stock was necessary to put the properties together and

finance the deal that we were then working on. It took a great deal of money to do that. In order to get this together we had to have positive options and deeds on our properties, and we took several properties over and paid substantial amounts on them." (R. 1221.)

Still later, upon the same subject, he testified:

"With reference to the conversation that I had with Wilkes with respect to his leaving the Italo Company and giving his attention to the new deal, that conversation was held in Los Angeles and I don't think anyone else was present. About this time the New York banking group had a representative in the field here and had concluded about what they could do. It was at that time that I told Wilkes to drop his connection with the Italo as it was in better hands than his own from the development standpoint, and to secure the properties that would be necessary to meet the New York requirements, that is, to help me secure them. We looked at a great many properties, and decided upon the Dabney and Johnson properties." (R. 1222-3.)

And after describing the properties finally decided upon by them, and their purchase price (R. 1223) he further stated:

"Wilkes did a lot of the negotiations for the properties and a lot of the dealings on them, with myself. He worked with me all the time. I furnished whatever security or money was necessary. When Wilkes started on the job he thought the money required to put the deal through would be furnished by myself, expecting of course that when the deal would be consummated my expenses

and money would be returned, and they would have been had the deal ever been finished." (R. 1224.)

With respect to the stock and money turned over to Wilkes for the purposes indicated John McKeon testified:

"I gave orders and directions to Shingle, Brown & Company, the escrow holders of the stock, to turn over stock to Mr. Wilkes. The orders are in evidence here. When that stock was needed and the money was needed for that stock in our transactions, it was delivered to Wilkes and sold on the market by him and the money put into our transactions. I know where most of the money went.

I had nothing whatever to do with the original transactions between the Italo and the McKeon Company and the turning of the stock over to Wilkes had no connection with that. That was not in the form of a commission or a compensation to Wilkes for inducing the Italo to make the deal with the McKeon Company. As it turned out it was never used for his personal benefit." (R. 1224.)

This phase of the controversy was given consideration in the testimony of Wilkes. After testifying to the request of McKeon that he step out of the management of the Italo Company and devote his time and attention to the reorganization and assist in getting it properly organized and financed, and what he and John McKeon thereafter did (R. 735-7), Wilkes testified:

"When I say, 'We made the payment' on these properties, I mean that I am not speaking of the Italo Company; that that was paid by McKeon and myself personally. With reference to the Dabney transaction in lieu of the payment of 200,000 in cash which was the option price or down payment demanded, a million shares of the McKeon Drilling Company stock was put up as security for the note. That may have been $250,000 instead of $200,000. With reference to the $10,000 in cash paid on the Delaney deal, that money was received from the sale of some of the McKeon stock. About the time we got this thing closed up with Vincent, and along about the first of November, Jack told me that he had arranged with his brothers Raleigh and Bob that he and I would go to work on the reorganization and refinancing of the Italo Company and acquiring of those additional properties, and that he had arranged with them to use any part of the McKeon Drilling Company stock that he saw fit in the securing of these properties and the carrying on of the program, and also for his own personal use." (R. 736-7.)

Subsequently upon this same proposition he testified:

"The money that was spent by McKeon and myself on the reorganization of the Italo was all McKeon's money although I was acting as his agent in handling it. When the final settlement came after the crash in the fall of 1929 it cost us over half a million dollars. A million shares were put up to secure the note to Dabney Johnson which were lost and we had to pay a deficiency judgment of $250,000.

Jack McKeon lost a ranch which cost in the neighborhood of $100,000. There was $10,000 paid to Delaney, $10,000 paid to O'Donnell, and including the attorneys' fees, accountants' fees, engineers' fees and expenses, and one thing and another, it ran up in the neighborhood of half a million dollars. That was money that was derived from the sale of the stock received by John McKeon which had been paid to the McKeon Drilling Company by the Italo Petroleum Corporation of America in payment of the properties of the McKeon Drilling Company." (R. 740-1.)

2. *John M. Perata and Paul Masoni.* On December 22, 1928, the Italo Company had agreed to purchase the McKeon Drilling Company properties, and more than two months after the McKeon Company's stock had been deposited in escrow, a written order was signed directing Shingle, Brown & Company, at the termination of the escrow, to deliver to Perata and Masoni, each 62,500 units of the escrowed stock belonging to the McKeon Company. (U. S. Ex. 105, R. 331-2; U. S. Ex. 108, R. 333.) The circumstances under which this stock was given to them were clearly shown by the undisputed evidence. The directorate of the original company, Italo-American Petroleum Corporation, consisted almost entirely of Italians. On May 28, 1928, the board of directors of the Italo Company was supplemented by the addition of nine Italians (R. 239-40), some or most of whom had been interested in the original company. On October 16, 1928, when Lacy was elected president of Italo

in accord with the understanding under which he accepted the presidency, he and a number of his business associates were elected directors in place of five other directors who resigned, four of whom were Italians. (R. 245-6.) On the same date Perata resigned as president, being supplanted by Lacy. (R. 245-6.) It is quite apparent from the record that at least until October 16, 1928, Italo was recognized as an enterprise supported and controlled by individuals who were either Italian born or of Italian extraction, and that, due to such fact, a number of their countrymen had become interested in the company, and furthermore, that those in control, took pride in the respective positions held by them.

When Lacy and his associates took control of Italo its offices were moved from San Francisco to Los Angeles. (R. 737.) When McKeon and Wilkes undertook to reorganize the company, which was late in 1928, it was quickly realized that in order to make the reorganization a success it was essential to obtain the cooperation, assistance and support of Perata and Masoni and their constituents. With respect to this matter Wilkes testified:

> "With respect to the receipts that have been put in evidence acknowledging the receipt of certain numbers of shares of stock for efforts in financing and organizing and furthering the interests of the Italo Petroleum Corporation of America, I know that when Lacy was elected president of the company on October 16th that he insisted that some of his other friends go on the Board of Directors with him and on the Ex-

ecutive Committee, and at that time Fred Keeler was elected a director to replace one of the Italian members of the board and Frank Chapin, an experienced oil man, Hugh Stewart, who had been associated with Lacy as vice-president of the Farmers and Merchants Bank, and some others went on the Board at that time, and the operating officers of the company were being moved to Los Angeles and there was a feeling among the Italian stockholders and among the Italian members of the board that it was sort of being taken away from them and that they were being shoved out of the company. About the first of November I could see that Perata and Masoni were no longer active in the company, and I told Jack McKeon that I thought it would be a very good thing, that I did not want those boys to become dissatisfied because they were going to be very valuable to us in more ways than one, and that they had worked hard on the thing and could do us a lot of good, particularly if we could get into the refining business and the distribution of it and we want to keep these Italians in it and we want to keep them interested, and I suggested to him that he give them some of his stock. There was no special amount mentioned, but the next time I was down here I asked Jack whether I should tell Masoni and Perata that they will get some of this stock that he was willing to use for his new company. And he said, 'Yes, go ahead and tell them. What do you think we ought to give them?' I said, 'I don't know'. but I think I said, 'Well, give them about half the amount we gave Vincent, it will do no harm and I think it will be a good thing'. So he told

me to tell them that he would give them 62,500 units apiece. There are the only two that have been mentioned here that I talked to McKeon about except Shingle and Brown. That is the first time that I ever discussed any division of this stock and it was not McKeon Drilling Company stock but Jack McKeon's personal Italo stock which he had received through some arrangement with McKeon Drilling Company which was to be used for his own personal benefit and for the purpose of organizing this new company. Neither Perata or Masoni had the slightest idea that they were going to get any stock until I told them so sometime in the middle of November." (R. 737-9.)

The reasons actuating the transfer of this stock to Perata and Masoni were described in the testimony of John McKeon, who stated:

"The people in San Francisco, who were the Italian stockholders, and at that time I guess about 20% of the stock was owned by Italians, and the loyal fellows that had been with the company a long time had been pushed aside, and there was a fast growing dissatisfaction in the company that I knew would eventually probably work a great hardship on all of us. So I attempted to straighten that out. I told Mr. Perata and Mr. Masoni, who had been the founders of the company and had the absolute confidence of all their stockholders, that if they would continue with the company and give it the loyalty that they had always given it and work with me, that I would give them some of this stock. The stock that I was going to give them was my

own property. That conversation with Perata and Masoni was in December, or late in November. It was before I went to New York.

I talked to Mr. Masoni in Los Angeles and to Mr. Perata in San Francisco. I told Masoni at the Biltmore Hotel, when I ascertained that he was dissatisfied, substantially as I have stated. I told him we expected to go on and enlarge the company, and that we needed the support of our present stockholders, and of our present officers, and that we did not want any different factions coming up in the company. At that time there was a great deal of it; and if he would help straighten out those factions and work with me I would give him some stock." (R. 1219-1220.)

And as illustrating the condition of mind of Perata and Masoni, McKeon further testified:

"About November 15th I saw Perata on the street in San Francisco and told him practically the same as I had told Masoni. Perata was very much upset about the fact that they were all being pushed out of the picture, and I did not want them to feel that way. Perata told me that he felt that way about it. I told them of my future plans, of the plans that I was trying to work out, and that if they would help me clear through that I would be very willing to give him this stock." (R. 1220-1221.)

And as showing there was no connection between the purchase of the properties of the McKeon Drilling Company and the assignment of stock, McKeon further testified:

> "My conversations with Masoni and Perata in which I agreed to give them this stock had no connection whatsoever with the making of the deal whereby the McKeon Drilling Company sold its properties to the Italo. My conversations with them were several months after the deal was made, and it had nothing to do with it at all." (R. 1221.)

The testimony of Wilkes and McKeon was confirmed by both Masoni and Perata. Upon this subject Masoni testified:

> "In the consummation of any of these deals there was no agreement between Wilkes or Perata or De Maria or any of the other defendants and myself that at any time under any circumstances I was to receive any of the commissions or benefits whatsoever personally from these transactions. There was never any such understanding at any time." (R. 819.)

And testifying with respect to the receipt of the stock, Masoni said:

> "Some time in April, 1929, I received 62,500 units of Italo Petroleum stock. Prior to receiving that stock, I had no understanding, agreement or promise from any of my codefendants that I was ever to receive anything in the way of a contribution from Mr. McKeon or otherwise in connection with the purchase by Italo Petroleum Corporation of America of the McKeon Drilling Company. In the early part of 1929 I was down here, and I met Mr. John McKeon at the Biltmore. He told me he was going to make a great big company, and wanted to make

it one of the biggest companies in the State of California; that he needed the help of all the Italian people, that I had contributed for the company, and although I might not be qualified to be secretary of the company, I could do the company a whole lot of good by sticking with the company and keep on doing the work that I had done in the past. He said, 'I am going to give you a block of my stock.' He never said how much; he never said when. That was in the early part of 1929 and that is the first intimation I had that he was ever going to give me anything at all. Previous to that time I had never discussed such a thing with any of my codefendants and had never heard of it. After I went back to San Francisco, A. G. Wilkes called me into the office and told me about the same thing as Mr. McKeon had told me, that I was going to get a block of stock from John McKeon. About a month or so afterwards, I received a letter from the McKeons to go over and see Mr. Fred Shingle, that he had something for me. I went over to Shingle-Brown, and they told me they had 62,500 units of Italo stock that was coming from Mr. John McKeon for my benefit. They presented me with a letter and told me to sign it to show that they had given the stock to me. I signed the letter and got the stock." (R. 822, 823.)

And as showing that there was no connection between the acquisition by Italo of the McKeon Drilling Company's property and the assignment to him of the stock, on cross-examination, Masoni testified:

"I never had any discussion with Raleigh McMcKeon or John McKeon or Robert McKeon in

respect to the acquisition by the Italo Corporation of the McKeon properties. Those men never at any time asked me directly or indirectly to vote for or approve or acquiesce in the purchase of the McKeon Drilling Company property by the Italo, and none of them promised me any reward in the event the properties were purchased by the Italo. When this purchase was made and I voted for it, I exercised my free judgment as to the advisability of acquiring the properties, and I was never dominated or controlled or forced into any such acquiescence by the act of any other person.

* * * * * * *

It was my judgment and opinion at the time the Italo Petroleum Corporation of America was being organized and its business being brought forward by the various steps, through the organization of the syndicate and the acquiring of these various properties, and the development thereof, that it was a sound business and that the company was and would be a success. I did what I did in good faith, believing in the soundness of the company and its condition." (R. 825-6.)

The evidence of John M. Perata is equally conclusive. After testifying fully to the circumstances under which he voted for the merger, including the acquisition of the McKeon Drilling Company's properties, and that there never was any understanding that he was to receive any benefit as a result of the purchase of the McKeon properties, with respect to the stock obtained by him, he said:

"The first time I heard of the 62,500 units of Italo stock that I later received from John McKeon was when I met Mr. McKeon one day on the street in San Francisco, and we were talking about the syndicate and things of that type, and I told him about the unfortunate situation of the syndicate, and he kind of smiled and said, 'Well, don't worry, Johnny, things will be all right. You will have a surprise one of these days'. Then about four or five months later I received a communication from Shingle, Brown & Company and they told me there was some stock down there, and I sent a messenger down, and I saw I had 62,500 units of stock. I signed a letter as a receipt for the stock, and there was no secrecy about it." (R. 838-9.)

3. *John B. De Maria.* De Maria was a director during the entire period of time mentioned in the indictment. He received 135,000 shares of common and 125,000 shares of preferred stock of Italo, aggregating 260,000 shares. Upon the trial of the action it was conceded by the Government that this represented a bona fide sale of 250,000 shares of stock for $200,000 and the assignment to him of an additional 10,000 shares was by way of price adjustment because of a drop in the market before delivery of the stock could be effected. No mention of it would be made in this statement excepting for the fact that notwithstanding its legitimate character De Maria was subjected to indictment, which indictment was not dismissed as to him until long after the trial in the court below had commenced.

The transfer of the stock was thus described by Robert McKeon:

> "With reference to the transfer of some of the Italo stock belonging to McKeon Drilling Company to Mr. De Maria we agreed to sell him some stock for $200,000. I believe it was 250,000 shares, and he was to receive delivery of the stock at the time the stock came out of escrow. That was the sale to De Maria. He paid $50,000 at one time, and about the time the escrow was broken up, he paid us about $90,000. He paid us a total of $110,000 and gave us his and Tommasini's note for $90,000. The stock had declined in price, so we settled up at the end of it for more stock than he had originally bargained for at the then market price, that is, to make him out the $200,000 I gave him 10,000 more shares at that time; I believe those were the figures. It was a purchase and sale and not a donation." (R. 1163-4; U. S. Ex. 297.)

Items 5 and 40 of U. S. Exhibit 297 confirm the testimony of McKeon. (R. 595-8.) The dismissal of the indictment as against John B. De Maria is noted on page 94 of the record.

4. *E. B. Siens.* Siens became a director of the Italo Company on May 28, 1928, and continued as such director until after the appointment of the receiver. According to the compilation of the Government's witness Goshorn he received 37,057 shares of common and 32,106 shares of preferred Italo stock. (U. S. Ex. 297, Items 29 and 50, R. 595-7.) A further item of 200,000 shares is noted as being "F. & M. Bank loan". (Item 35.) According to Goshorn's

compilation, showing "realization" from the disposition of the McKeon Drilling Company stock, it is asserted that the defendant Siens received $238,277.45, 87,057 shares of common and 32,106 shares of preferred Italo stock. (U. S. Ex. 297, R. 598.) The injustice of this compilation, which was permitted to be introduced in evidence and observed by the jury is strikingly shown by these figures. The evidence, without contradiction, demonstrates that Siens never personally benefited by any of the stock, but it was used exclusively in connection with the financing of the Italo Corporation and for its benefit or the benefit of the proposed larger reorganization or in connection with the properties and business of John McKeon which, because of lack of proper attention by him, due to his activities in the proposed reorganization, were subsequently entirely lost to him. Goshorn conceded upon cross-examination that he merely followed the stock and the proceeds into the name or possession of the individual named, without attempting to ascertain to what purpose it was intended to be devoted, or how it was ultimately used, thus subjecting the individual to the imputation that the money and stock had been appropriated to his own use. (R. 611-615.)

With respect to the defendant Siens, John McKeon testified:

> "All the stock that went through my account or Mr. Siens' account was all for my account. I had had a good many dealings with Mr. Siens for several years.
>
> Prior to getting into the Italo transaction I came into possession of some land in San Bernar-

dino, in the city, vacant land in the business section, and I built a big business and office building and a hotel. That work was looked after and taken care of and worked out principally by Siens. Siens worked out the deal and handled the money and the project for me. That building and all was going on late in 1928 and early in 1929. That work had connection with the stock which was turned over by me or ordered turned over by me to Siens that went through Siens' account. That is the way I was financing part of that work down there.

I financed that work through the sale of stock which Siens handled, and those transactions are all set up in a special set of books that I have which are not in evidence. Those transactions by which stock or the proceeds from the sale of stock went into Siens' possession had no connection with the making of the sale of the McKeon Drilling properties to the Italo. None of that money or stock was given to Siens in consideration of his influencing the making of that deal by the Italo Company. I had no understanding with him that he was to receive any of that stock, or anything else, at the time or about the time the transaction was made by which the Italo acquired the McKeon properties." (R. 1225.)

And explaining item 35, U. S. Exhibit 297, reading

"E. Byron Siens F. & M. Bank Loans 200,000 shares"

John McKeon further testified:

"(This item) refers to the Farmers & Merchants National Bank loan which I made. I got the benefit of that loan, and that stock and that stock was used to secure that note. That 200,000

shares does not represent any compensation or contribution which I was making to any of the officers or directors of the Italo Corporation to induce them to defraud the stockholders of that corporation or to induce them to make the deal by which they acquired the McKeon properties. That arrangement had not been made, and there was no agreement that it should be made at the time that transaction took place." (R. 1229.)

Upon cross-examination with respect to this item, John McKeon further testified:

"I sent Mr. Siens to the bank to borrow $50,000 for me, on my note; I believe they let him have the $50,000, but they wanted security on the note, and he said he would furnish them some Italo stock, and they said they had so much stock of the Italo in the bank for security that they wanted something else, so he told them I had some other stocks in a brokerage house, which I had a $50,000 equity in, and they said that instead of lending the $50,000 they would lend $107,000 and for me to have the broker send the stock over to the bank, and they would pay him the balance on it and would loan us $107,000, which they did. In the meantime I believe they allowed us to use the $50,000 which I wanted to borrow on my note. The second note was made in the name of E. Byron Siens. My note was sent to the bank, but I do not know what the mechanics of the deal was." (R. 1236-7.)

And that John McKeon was authorized by his brothers to use stock in connection with his own real estate transaction difficulties is likewise shown by John McKeon, who, in testifying to the conversation occur-

ring between himself and his brothers, relative to the use of the stock, in part said:

> "Also I was to use a part of that same stock to straighten out my real estate affairs and difficulties I had gotten into in San Bernardino, and I needed some money. That was in November, 1928. It could have been the latter part of October or the first part of November, 1928. It was after October 26, 1928." (R. 1238.)

It was also intimated by the Government that Siens received some money as a result of the sale by the International Security Company for the McKeon Drilling Company of 60,500 units of stock, which were sold through a Mr. Bentley. As to this matter, John McKeon testified:

> "That stock was sold by Mr. Bentley of the International Securities Company, but E. Byron Siens did not get the money derived from that. We got the money derived from the sales of that stock. I believe that happened to be credited to Mr. Siens on our books because I believe Mr. Bentley was selling stock, as I understood it, for Mr. Vincent. He got into some difficulty down here as Vincent's agent and we furnished the stock to take up the sales that he had made through the bank escrow, the same as he did in San Francisco. Mr. Siens looked after the details of that deal for us to see that the stock went into the bank and to see that the stock was delivered to the people who paid for it, and brought the check over and paid it into our office, if I remember correctly. If that money was later credited to the account of E. Byron Siens, he gave us nothing for it. He never got credit for that money.

I do not know that any of that money was delivered to Mr. Siens directly by Mr. Bentley." (R. 1240-1.)

This testimony was corroborated by Bentley, a witness on behalf of the Government. (R. 477-9.)

On December 22, McKeon Drilling Co., Inc. through John McKeon, gave Siens an order on Shingle-Brown Company, to deliver to him 30,636 shares of common and 32,362 shares of preferred Italo stock. With respect to this order, the defendant Brown testified:

"They stated to me that the Siens stock had something to do with the personal relations between Jack and Siens; they were partners before, and as I understood it, in some large San Bernardino real estate transaction and also a breeding farm for breeding horses." (R. 996.)

On cross-examination, touching upon this order, John McKeon testified:

"The stock that I ordered given to Siens in that and other orders and the stock that was delivered to Siens was delivered for my account and benefit. He was to and did perform certain services for me, and I was to personally receive the benefit of those services.

Q. It was not for any services that he had or expected to perform for the Italo Petroleum Corporation of America, is that correct?

A. Well, of course, he had performed a lot of services for the Italo. He probably received some profit on some of that stock. I don't know how much." (R. 1245.)

One phase of the Siens situation will be given further consideration in discussing the delivery of stock to Westbrook which he had borrowed. To avoid duplication it is not here referred to.

5. *James V. Westbrook.* In February, 1929, James V. Westbrook received 2,500 units of no par Italo stock which was the equivalent of 25,000 units of $1 par stock. (R. 801.) The stock was delivered to him pursuant to an order dated December 22, 1928, signed McKeon Drilling Company, by John McKeon, directing Shingle, Brown & Company, escrow holders, to deliver to Westbrook 25,000 units of the McKeon escrow stock. (U. S. Ex. 107, p. 33.) The record discloses without conflict that this stock was given to Westbrook solely and exclusively by way of adjustment of a controversy over certain shares of Brownmoor stock occurring between Siens and Westbrook, claimed to have been owned by Westbrook, and had nothing whatever to do with the acquisition by Italo of the McKeon Company properties.

Westbrook was elected a director of Italo on May 28, 1928 (R. 239) but although he was notified of such election he never attended a board meeting and had nothing to do with anything transacted at the board meetings of Italo. (R. 802.) This testimony of Westbrook is corroborated by the minutes of the proceedings of the board of directors of Italo introduced in evidence by the Government. (R. 240-245.) Westbrook resigned as director on October 16, 1928, when Lacy and his associates were elected directors. (R. 245-6.)

Siens, Shores and Westbrook owned 500,001 shares of stock in the Brownmoor Oil Company which stood of record in the name of E. Byron Siens as trustee under a voting trust. (R. 633; 800.) Westbrook also claimed one-third of 49,000 odd shares which were not included in the voting trust control. (R. 800.) At the time of the sale a dispute arose between Westbrook and Siens over the former's interest in the 40,000 odd shares, as well as over 250,000 Brownmoor shares which were coming from Monrovia Oil Company previously held by it as security for the $100,000 obligation of the Brownmoor Company. (R. 800.) John McKeon acted as arbitrator of this dispute and agreed with Westbrook that there was due to him 11,600 shares out of the 49,000 odd shares. At the request of Siens, McKeon agreed to give Westbrook 25,000 units of Italo stock out of the McKeon escrowed stock, when it came out of escrow, and on November 28, 1928, gave Westbrook a letter to that effect. (R. 801.) After testifying to the character of the dispute between himself and Siens regarding this transaction, Westbrook said:

> "Siens wanted to have John McKeon act as arbitrator of our dispute and McKeon agreed with me that Siens had made about 11,600 shares out of the 49,000. I insisted on my share of the 250,000 shares, and after John McKeon had agreed to protect me for the 11,600 shares we agreed to leave it to him to settle. Mr. McKeon agreed to give me Italo stock, which was in escrow, and gave me a letter for my protection, which is Exhibit Q in evidence as follows:" (R. 800-1.)

Exhibit Q, which is the letter above referred to, is set forth. (R. 801.)

He further testified:

> "The 2,500 units of Italo stock that I received had nothing whatever to do with the Italo-McKeon deal, but was given to me for the balance of my interest in the Italo Company by Mr. McKeon at Siens' request." (R. 802; 812.)

This transaction was called to John McKeon's attention upon cross-examination and after testifying that he heard something to the effect that the 250,000 shares of Brownmoor stock held by the Monrovia Oil Company had been cancelled, he said:

> "I don't recall exactly the mechanics about the matter, although I know there was a dispute between Siens and Westbrook. I did not make any inquiry at that time as to whether the other stockholders of the Brownmoor were going to fare because of the failure to cancel the 250,000 shares of stock transferred to the Brownmoor Company by the Monrovia Company in return for the lease. I had no interest in the deal or in the stockholders. Westbrook and Siens had a dispute in which they finally agreed that there should be a settlement made, and whether that is what it was about or whether that was the dispute or not, it was no affair of mine at all. I gave 50,000 shares of stock to Mr. Westbrook to satisfy him at the request of Mr. Siens and did not receive any money for that stock." (R. 1243.)

McKeon also testified that it was agreed at the time that Siens and Westbrook would finally work out their own settlement and that he expected to get the stock back or be compensated for it, but never was. (R. 1243.) He characterized the transaction as a

guarantee that they would adjust their affairs (R. 1245), and then gave the following evidence:

> "The fact of the matter was that Siens and Westbrook, in the future, were to make a settlement and I was to be relieved of the obligation if they did. If Siens were unable to do so, why, of course, I had guaranteed a settlement with that stock, and I was not under any obligation in the matter at all. That stock was delivered to Westbrook to guarantee him that the claim would be satisfied or otherwise he would have the stock." (R. 1246.)

Comment was made by the Government upon the character of receipt that was signed by Westbrook for the stock. This receipt was a "stock form" of receipt that was generally signed by those who received any part of the escrowed McKeon stock. Because of this fact the form and substance of these receipts will be given attention later under a separate heading. McKeon stated, however,

> "that receipt does not entirely reflect the transaction." (R. 1246.)

That the receipt by Westbrook of the stock in question had nothing whatever to do with the acquisition by Italo of the McKeon Company properties is of course obvious from the circumstance that he never attended a directors' meeting, knew nothing whatever about it and never voted upon any project, as well as for the reasons already given. However, he testified directly upon this subject and his evidence was not disputed. (R. 802; 811-2.)

By its verdict the jury acquitted Westbrook, as well as his associate, Howard Shores, upon all counts.

6. *Maurice C. Myers.* Since 1914, except during the war when he was a Major in the air service, Maurice C. Myers has been practicing law in Los Angeles specializing in corporation work and oil matters. Since his return to civil life he has been a partner of William Spalding. (R. 1035.) In the practice of his profession he had specialized in those branches of the law relating to corporations including those engaged in the production and distribution of oil, having represented many oil companies. (R. 1035.)

Commencing in April or May, 1928, the firm started to take care of legal matters for the Italo Petroleum Corporation in southern California. (R. 1036.) Before becoming the attorneys for the Italo Company the firm performed legal services for McKeon Drilling Company. (R. 1036.) Practically all of the legal work on behalf of the Italo Company necessarily rendered in connection with the original consolidation was given attention by Mr. Myers. These services were detailed by him with great elaboration upon the trial. Among the services rendered he had drawn by actual account more than 2000 different contracts for the company. (R. 1055.) During the rendition of these services some of the contracts under which the properties were acquired were taken in his name, one of the principal reasons being that

> "it was thought advisable not to disclose the principal especially after it became known that the Italo was in the market to buy properties." (R. 1038.)

Among other services rendered by him was the preparation of and attention to the application for the issuance of the permit by the Corporation Commissioner authorizing the consolidation and the issuance of stock for the purpose of acquiring the properties. (R. 1039, 1042-7.)

Myers became a director of Italo on October 16, 1928, at the request of Mr. Lacy when the latter and his associates were elected directors. (R. 1047-9.) His only real participation in the matters, however, was in connection with legal or semi-legal matters. (R. 1048.) He resigned as a director about the middle of 1930. (R. 1048.) During the period of approximately twenty months $35,000 had been paid to Spalding & Myers for legal services rendered on behalf of the Italo Company. (R. 1049.) According to Myers

> "I wouldn't think that that was an exorbitant fee. In fact, I am sure that it was less than our actual cost of doing business. I would say that the expenses ran over $2000 a month and about 75% of the office work was devoted to the Italo Petroleum Corporation of America during that period of time beginning in April or May, 1928, and continuing on through 1929." (R. 1049.)

At the termination of the escrow Myers was given 62,500 units of the stock in two blocks, one for 32,500 units and another for 30,000 units. (R. 1049.) This stock was received in April and May, 1929. The 32,500 units were divided between Spalding and Myers. The second block was divided only partially between Spalding and Myers. (R. 1050.) With respect to the cir-

cumstances under which this stock was received by Myers, he testified:

> "The first time I had any knowledge that I was going to acquire any stock from McKeon Drilling Company was early in 1929. My partner had often asked me what I was going to do about having an understanding for a payment for our services. I felt as a result of the conversation with him that I should speak to the officers of the company, that is, to Mr. Lacy and Mr. Bob McKeon, who was then over in the office acting as general manager, and one afternoon when I was playing golf with Mr. Bob McKeon he said to me, 'Maurice, you have done some very good work and we realize it and I am going to see that you are well compensated if I have to do it myself.' I remember that very well because I communicated that information to my partner. In substance Mr. Bob McKeon said, 'Your work has been very satisfactory and we appreciate it. We know that you have done a lot of hard work and you have been badly compensated. You have not been adequately compensated and I am going to see that you are if I have to do it myself personally.' He also mentioned at that time that a lot more work would be asked of us, because at that time and for one or two months before, we had been spending a great deal of time in the way of qualifying the Italo properties for the proposed McKeon Oil Company deal which was then pending. I never knew the definite amount of stock we were to get until the second payment. Mr. McKeon told me that a substantial block of stock would be set aside by him alone, if necessary, out of his personal holdings. I don't know how much the stock would

amount to until I got the last envelope from the McKeon office.

Other than the 63,000 units I received from McKeon Drilling Company I did not receive any other stock from the McKeons or the company." (R. 1050-1.)

With respect to the work done by Spalding & Myers in connection with the contemplated consolidation known as the McKeon Oil Company, Myers testified:

"I prepared to draw some contracts, options and agreements to purchase the various properties and look into the reports on title and such things as that. The law firm of O'Melveny, Milliken, Tuller & Myers handled a good deal of that work also, in connection with this matter, and I worked in conjunction with them constantly for months on that line of work. A report was prepared by the firm of O'Melveny, Tuller & Myers, addressed to the firm of Palmer & Company and to Cadwalder, Wickersham & Taft in New York, preliminarily reporting upon the properties of the Italo Corporation of America." (R. 1055.)

When Myers received the stock he likewise signed a "stock form of receipt" (R. 1056-7) to which reference will hereafter be made under a separate heading.

William D. Spalding, a well-known practicing attorney of Los Angeles, was Myers' partner. In August, 1928, he sustained injuries which for a considerable period incapacitated him from giving much attention to their legal practice. (R. 1026.) When testifying to the services rendered by his firm with

respect to the receipt by Myers of the stock above mentioned, he testified:

> "During the time that we represented Italo Petroleum Corporation of America as their counsel there was never anything that I know of that was irregular, improper, unethical or unlawful in the transactions of myself or Mr. Myers with regard to the Italo Petroleum Corporation. I remember when Myers received a large block of the Italo stock. I believe it was about 42,500 units. Mr. Myers divided that stock with me on an equal basis. Mr. Myers said at the time that the 42,500 units came from the office of the McKeon Drilling Company. I do not know if Myers told me why I received it but I knew it was received as a fee for services rendered by our firm and it was so considered by both of us. I felt that our firm had earned that money represented by that stock." (R. 1028.)

On cross-examination he further testified:

> "Mr. Myers received some other stock from the same source, but didn't divide it with me. The services that we had performed for the McKeon Drilling Company and the Italo Petroleum Corporation of America were partnership services. If I had not been incapacitated for a year it would require a little different distribution. When I came back to work Mr. Myers and I made what we deemed an equitable division under the conditions that then existed, satisfactory to both of us, of the profits or assets of the partnership. Myers told me of the additional stock that went to make up the 62,500 units." (R. 1031-2.)

It is obvious, however, that in referring to the McKeon Drilling Company Spalding intended to refer to the "McKeon Oil Company", on behalf of which considerable legal services had been rendered for which no compensation had been paid. (R. 1065.)

The purpose for which this stock was given to Myers is explained by Robert McKeon, his testimony being:

> "The stock was not delivered to Maurice Myers in payment for attorney's fees as Mr. Spalding testified. My purpose and my idea in delivering the stock to Myers was that there were not any attorney's fees involved in the transaction at all. The McKeon Drilling Company had paid Spalding & Myers for all services ever rendered, paid them in cash. I considered that the Italo was capable and should pay them for any direct services that they had done for the Italo, and this was given just like it was given to the other persons by the McKeon Drilling Company for their aid in the Italo. That was all. In my mind there wasn't any consideration of attorney's fees at all. I do not know, however, how Spalding & Myers treated that transaction. All I know is that in my own mind I regarded it as a donation made, and if they treated it as being payment of attorney's fees, that is something I know nothing about." (R. 1163.)

In corroboration of the evidence of his brother on this subject, John McKeon testified:

> "The stock given to Maurice Myers was not given to him in connection with this transaction. (Sale of McKeon properties to Italo.) I didn't

have anything to do with that, but it was handled by Bob McKeon. I know that the stock was given to Myers, and Bob said that we seemed to be pretty liberal with the stock and that he figured Maury Myers had worked about as hard and done as much for the company as anybody else, and as long as other people were getting the stock he insisted that Myers should have some, so I told him to give him what he thought he ought to have." (R. 1226.)

Inasmuch as Myers was not elected a director of Italo until October 16, 1928, it is not and of course could not be claimed that he had anything whatever to do with the acquisition by Italo of the McKeon properties. (R. 1163.)

7. *Hugh Stewart.* As has already been shown, Hugh Stewart was not elected a director of the Italo Company until October 16, 1928. He had been manager of the Farmers & Merchants Bank for twenty years. (R. 1216.) In the early summer of 1929 he received 25,000 shares of Italo stock that belonged to the McKeons. With respect to this transaction Robert McKeon stated:

"In the early summer of 1929 this eastern consolidation or financing that Jack had been working on had pretty definitely come to an end, and Mr. Stewart was one of the directors of the Italo Company. I had been general manager of the company since April, 1929, and each month we were confronted with the payment of around $250,000 on the purchase price of the properties that had not been fully paid. We had an audit made by Peat, Marwick & Mitchell and found

that the total indebtedness of the company at that time exceeded some $3,000,000, and it was all current. We had to adjust it every month, make what payments we could, and it was a very hard load to carry. We thought it would be very possible to fund those debts in some manner, either under a bond issue or a large loan, and I told Mr. Stewart if he would assist me in financing such a loan (he was a banker, and had been connected with the Farmers & Merchants Bank here for many years and was a financial man, and I felt he would have much more success in securing or finding such a loan than I would) I would give him that stock as a present or a bonus for those services. As a result I agreed to and did pay Mr. Hugh Stewart 25,000 shares of stock for his services in endeavoring to bring about a funding of the indebtedness." (R. 1164-5.)

Our understanding is that the integrity of this transaction is not now challenged by the government. It eloquently portrays, however, the purpose sought to be achieved by the McKeons in the distribution of their stock, and strips each one of those transactions of any sinister aspect.

8. *Shingle-Brown & Company* (Fred Shingle and Horace Brown). Neither Shingle nor Brown was ever a director or officer of the Italo Corporation. Until Wilkes and Vincent took up with Shingle the negotiations which resulted in the $80,000 loan, neither had had any connection whatever with Italo or its predecessor. (R. 883-5.) Shingle subsequently became manager of the so-called big syndicate to

which reference has already been made, and when Vincent & Company failed in its commitments and jeopardized the financial structure of Italo as a result of its activities, he deposited as security for one of the $300,000 loans made by the Farmers & Merchants Bank, two million shares of syndicate stock, with respect to which, however, he was indemnified by John McKeon; and subsequently organized the so-called broker's pools through which the syndicate stock was sold and Italo permitted to complete its purchases.

Both Shingle and Brown likewise rendered intensive service in connection with the contemplated larger consolidation which finally failed of accomplishment, and had agreed to subscribe for bonds to the extent of $5,000,000 and in connection therewith had arranged their affairs so as to be financially able to purchase the bonds. References to the record substantiating these statements have already been made in an earlier part of this statement.

Out of the McKeon Drilling Company's escrowed stock Shingle and Brown, for themselves and their company, received 450,000 shares of stock. That there was nothing illegal or illegitimate in the distribution of this stock to them is made manifest by the record. Upon this subject Wilkes testified:

> "Jack McKeon and I had several discussions about the New York people and about reorganizing the Italo Company changing the par value of the stock and acquiring some different and additional properties and doing our financing the way we had always done it, through the New

York banks. About the time the brokers agreed to take on the financing of the company, Jack McKeon told me that I could tell Shingle and Brown that if they took hold of the situation and cleaned it up and got these properties paid for and got the company in financial shape and raised the three and a half million dollars that was necessary that he would see that they got some compensation." (R. 735.)

And while testifying upon cross-examination respecting the same $25,000 that Shingle, Brown & Company received out of the sale of some stock, he testified:

"Q. Why was it that Fred Shingle & Company received $25,000 out of this money?

A. That was an arrangement with Mr. John McKeon. It was understood by that time that Shingle-Brown would get certain shares of John McKeon's personal stock for the work that they had done for the company." (R. 777.)

Shingle, in testifying to a conversation between himself and John McKeon before undertaking the formation of the broker's pool, said:

"We also had a talk with Jack McKeon about that time. He was very much exercised and said that something had to be done in order to save the whole situation and he urged us and wanted to know if we could not get in and get some of our local firms to really investigate the company and form a pool, and he said that if we would do that he would see that we were compensated. * * *" (R. 911.)

"Prior to that time Wilkes told us that if we would get into the matter he would see that we

would be compensated, so that we had that assurance from both John McKeon and Wilkes." (R. 911.)

And in testifying why Shingle, Brown & Company were to receive one-half of the 961,510 shares of common stock, being the balance of the so-called McKeon stock, he testified that

"Mr. Brown told me that he had had a talk with Mr. Wilkes and that Wilkes told him that he had a large block of McKeon escrowed Italo stock which McKeon had given him instructions to distribute more or less at his disposal to help out this big deal. After Brown delivered this letter to me," (U. S. Ex. 11), authorizing the delivery of said stock "I had a conversation with Wilkes in which I asked him about the stock and he gave me full instructions as to what to do with it, namely that we were to keep half of that 961,000 for ourselves and distribute the other to himself and to his order after taking out for further distribution that he was still to make. He told me that the McKeons had sometime previously to that told him to use the large block of this stock in furtherance of the big deal and to more or less use his best judgment where he thought it would do the best good for the big deal. This was in connection with what the broker's pool had done in putting across the deal plus our commitments for $5,000,000 of bonds. Wilkes was very appreciative of what we had done and what he would expect us to do in the future. With respect to the proposed eastern deal he told us at that time that negotiations were very close for that big deal and that he expected a representative of Palmer & Company would be

out soon after the first of the year and negotiations would probably be closed at that time." (R. 919-920.)

And in indicating the reasons why this stock was not returned when the deal fell through, he said:

"The McKeon deal did not go through and we did not give back the 450,000 shares because we had performed a pretty good service and had saved this company once, and I think that compensation was given to us for that, probably more or as much anyway as standing by and helping finance in the future. We would expect pay for something we did and we didn't get paid until after we had done the job." (R. 935.)

The defendant Brown, in testifying to a conversation occurring between himself and John McKeon when the $600,000 was borrowed from the Farmers & Merchants Bank, among other things said:

"He said, 'I think you will see that this is good enough for you to interest yourselves in it and your friends,' and asked us if we could not interest a group of reputable brokers in this concern, enough to pull it through. Incidentally, he said if we could do so he would see that we were not sorry for it. I told Mr. McKeon I would take it up with Fred Shingle when I got back to San Francisco." (R. 986-7.)

Upon his return to San Francisco Brown conferred with Shingle, after which Wilkes again spoke to them. As to these conversations, Brown testified:

"Our conversations with Mr. Wilkes were along the same lines, asking us if we would get

> together on this thing. He said if we would he would see that we were substantially rewarded somewhere along the line for our services, if we could pull this thing through." (R. 989.)

When Shingle, Brown & Company sent the McKeon Drilling Company a check for $86,310.40 received from the sale of some of the stock escrowed to take care of the Vincent situation, Robert McKeon sent them a check for $21,000. Explaining the reason for this check, Brown testified:

> "Robert McKeon had a check made out for some $21,000 and stated to me that that was a part of his appreciation for what we had done in handling this matter. That was the first compensation that Shingle, Brown & Company had received for the work they had done in the matter." (R. 1003.)

The check referred to is dated December 14, 1928, and is a part of U. S. Ex. 104.

He further testified:

> "I had had no prior understanding with Robert McKeon of any nature whatsoever that I was to receive that money." (R. 1004.)

And referring to the distribution of the 961,510 shares of escrowed stock, one-half of which was turned over to Shingle, Brown & Company, Brown testified:

> "Bob and Jack McKeon told me that that stock was to be placed at the direction of Mr. Wilkes to be used by him in compensating us and also to be used in working out the McKeon

> Oil Company picture. * * * He told us at the time that the stock was in compensation for the services we had performed in getting this deal through when it looked very bad, and also for standing in line for the larger picture." (R. 1005.)

And as indicating that he did not believe that the compensation was excessive, he said:

> "I considered that the stock which we received from the McKeons was compensation for what we had done in the past and what we were to do in the future. I considered the compensation very substantial, but it represented about 10% of the McKeon Drilling Company's stock, which I did not consider an excessive cut in consideration of what we have done and were prepared to do." (R. 1005-6.)

The McKeons, from whom this stock came, appreciated the services rendered and to be rendered by Shingle, Brown & Company and believed that they should be compensated by the stock and moneys which they received. In indicating his belief upon the subject John McKeon testified:

> "With reference to the entries on Exhibit 297 showing approximately 450,000 shares of common stock going to Shingle, Brown & Company out of the McKeon escrowed stock, I figured that Shingle, Brown & Company were very well entitled to it, because I realized that if it had not been for the assistance of Brown and Shingle in September or early in October that our whole project would have collapsed, and I realized at

that time that Italo stock, unless the financial program was worked out, wasn't worth anything, that it would be selling for ten cents a share or less. I realized all those things at the time I agreed to give them the stock. That was at the time I agreed to use the stock and settle with Vincent. I agreed to it as an inducement to the other brokers. There was no specification as to the amount of stock they were to receive, and we all figured that it would be a very hard job, and nobody contemplated that the money would come into the syndicate and that the sale of stock would be as rapid as it was. We contemplated that we had a year's or a half year's work ahead, and they completed it in approximately sixty days. That was after the company was reorganized and Mr. Lacy put in and the stock went over night.

I also knew in December, 1928, that Shingle, Brown & Company had verbally agreed that they would finance one-half of the $10,000,000 bond issue that was then proposed, and that agreement was all made and entered into before I decided how much stock I was giving them." (R. 1234-5.)

That none of this stock represented any sinister understanding, agreement, or transaction is shown by the evidence of Fred Shingle:

"At or prior to the time that the contract was made between the McKeon Drilling Company and the Italo Petroleum Corporation of America, I did not have any agreement or understanding, tentative or otherwise, with any one of these McKeons that I was to get any part of the stock which was to be issued in consideration of the

transfer of the McKeon Drilling properties to the Italo. At that time or immediately thereafter, when the syndicate was being organized, I was not informed by any person that there was any such agreement as to anybody, with the McKeons, that the McKeons would give any part of that stock to anybody else. So far as I know, each one of these transactions, whereby the McKeons gave, sold or disposed of their stock to various persons, those transactions arose at or about the time they took place, and that is true with respect to the stock which was transferred to Shingle, Brown & Company and to me personally. The stock that was transferred to me personally, was transferred to me for the benefit of my firm." (R. 929-30.)

It also appears affirmatively that neither Shingle, Brown, Jones nor Mikel was at any time an officer or director or connected in any way in any official capacity or fiduciary relationship with the Italo or with any of the other companies mentioned in the evidence. (R. 930-1.)

Form of receipt.

The receipt signed by most of those who obtained stock out of the McKeon escrow contained a statement that the stock was being received

> "for organizing, financing or otherwise promoting the interests of Italo Petroleum Corporation."

It is conclusively shown by the evidence that the form of this receipt was copied from a receipt which had been previously prepared by Maurice C. Myers for the

signature of Vincent & Company when certain stock was turned over to it at the time of the cancellation of its contract. When Myers received the stock given him he signed a comparable receipt, his testimony being:

> "He (Raleigh McKeon) handed me the receipt to sign and I started to sign it and saw the amount of stock just glanced over it hurriedly, and I saw the last part of it, and I said, 'Raleigh, that's a funny receipt.' It said, as I recall it, 'for organizing, financing, or otherwise promoting the interests of Italo Petroleum Corporation'. I said, 'That's not right, because I was not either an organizer or interested in the financing or promoting of the Italo Petroleum Corporation, and most of my work here has been for the McKeon Company in the last six months.' He said in substance, 'This is the receipt I am asked to have signed, and it is the same receipt that others are signing.' I said, 'Well, I guess it doesn't make any difference.' " (R. 1056-7.)

And after referring to a conversation subsequently occurring between himself and his partner, Spalding, he further testified:

> "During the conversation with Raleigh McKeon I don't believe I asked him who drew the receipt or where the wording was secured.
>
> I know now that I drew a similar receipt to that, being a receipt drawn just a few days prior to that for Frederick Vincent & Company. It was a receipt for two hundred and some odd thousand units in order to close up the Vincent contract. Horace Brown and Bob McKeon both gave me directions to settle up the contract with Vincent &

> Company, and in so doing I included a paragraph which is in identical language with Exhibit 122. I found that document among the exhibits here." (R. 1057.)

With respect to this receipt, Robert McKeon, who typed it, testified:

> "Exhibit HHH is a carbon copy of a letter that I obtained from the files and used at that time. That part of the letter reading as follows is a paragraph from which I got the language regarding the commissions, etc. 'for all services of Frederick Vincent & Company and the members and employees of said company in organizing, financing and otherwise promoting the said Italo Petroleum Corporation of America'. That receipt, having been prepared by an attorney, I thought it was a good form and used it." (R. 458-9.)

The carbon copy of the letter referred to (Def. Ex. HHH) will be found on pages 1071 and 1072 of the record.

The use of this form of receipt was also explained by John McKeon on cross-examination when being questioned about the receipt signed by Westbrook, his testimony being:

> "There was a stock receipt that was used in that escrow to account for all stock that was delivered out. The language of the receipt was copied from a receipt made by Maurice C. Myers when he closed up with Vincent. Our office used that as a copy." (R. 1245.)

Proposed set-up of transaction by McKeon Drilling Company for federal income tax purposes.

The court's attention has already been directed to the financial situation confronting Italo, as well as the McKeon Drilling Company during the fall of 1928; the action taken by John and Robert McKeon to save Italo, as well as their own investment, from serious financial impairment; the plans proposed by Italo and themselves for bringing into existence a larger consolidation with adequate financial support; their agreement to devote their stock up to 2,500,000 shares to such purposes, their actual use of large blocks of such stock in connection with the Vincent & Company situation and their commitment to Shingle Brown Company for the services to be rendered by them in providing finances to Italo for its requirements. We have also pointed out that on October 16, 1928, all but 60,500 units of the drilling company's stock was escrowed, and delivery thereof could not be obtained by them at least until after the expiration of 90 days.

Having this entire situation in mind, the McKeons naturally became worried about the amount of the income tax that they would be required to pay to the Government upon this transaction.

When the drilling company's properties had been in fact transferred over to the Italo on October 15, 1928, it became necessary to verify the liabilities of the McKeon Company which were assumed by the Italo and to furnish the Italo with sufficient information to enable it to set up upon its books the various properties acquired, including depreciation and depletion, as well

as to close up the drilling company's books as of October 15, 1928. (R. 1148.) Upon this subject Edgar P. Lyons, the accountant employed for that purpose testified:

> "I believe that the McKeon-Italo deal was completed at midnight October 15, 1928, and those entries were made to relate back to that time.
>
> When Mr. Thackaberry called upon me to perform this accounting work he told me that this deal had been made whereby the McKeon Drilling Company were selling their properties to the Italo, and informed me that the Italo were to assume some $500,000 of their liabilities as of October 15th, and asked me to determine those liabilities as of that date and to get up any other relevant data from their books in which the Italo might be interested. I proceeded to do this. In a general way this work included the verification of the liabilities and a detail of their liabilities which were to be transferred, the preparation of journal entries to correct the McKeon books with respect to those liabilities, going over their asset accounts or detailed well accounts and obtaining amounts of equipment of various kinds which had not yet been depreciated and charged off, and in computing the depreciation and those assets up to October 15th." (R. 1100.)

See also testimony of Robert McKeon. (R. 1148.)

Having employed Lyons for this purpose, Robert McKeon discussed with E. A. Thackaberry, secretary and bookkeeper of the drilling company, the income tax phase of the deal.

> "With reference to the exhibits in evidence written by Mr. Lyons, I know that Thackaberry

and I discussed the proposition of the income tax phase of the deal with the Italo, as to what our income tax would be. We had received very little money in cash for our properties at that time, in fact I think only the sum of $250,000 in cash, and the Italo Company had our properties, and we had in exchange for them a lot of notes of the Italo. We had accepted $300,000 in subscriptions to the syndicate which we had charged to Jack's account, and the Italo had also assumed our liabilities but had not paid hardly any of them at that time; so we were confronted with the situation of how to set this deal up on our books with a view to the income tax." (R. 1148, 1149.)

And after having fixed the discussion as occurring during the latter part of November (R. 1149) Robert McKeon proceeded:

"Thackaberry had been employed in the income tax department before, and we knew that if we would set that up at a high valuation on our books, that is, give it the full six million valuation, it would show a tremendous profit. The leases we had turned in to the company had been obtained, many of them, for the privilege of drilling wells on them. They stood on our books at a certain cost. Maybe a well that was a big producer would have cost $100,000 or $80,000, and that is the way it stood on our books. The whole group of properties it seems to me as I remember it had cost us about $1,500,000. If we set that up at $6,000,000, we would have to pay a profit on around four and a half million dollars, and we were not at all sure that our considerations were going to be worth four and a half million, or we didn't know what they would be worth. We had the notes of the

company, we had the stock, and we had those subscriptions to the syndicate, and we did not know what they would be worth. We talked about it quite a lot. In fact, I asked him what the position would be if we would set this up at six million as a consideration and made that income tax return at the time it was due, and if by the first of the year the Italo could not perform their obligation and we had to take the properties back. Our stock would then be worthless, and probably most of our liabilities would come back on our hands. Thackaberry said, 'You would probably get a refund on it, but getting a refund from the Government is no easy job.' So I said, 'Well, you get Lyons over here and you fellows figure out to pay the least possible income you can this year on this deal. The next year or the year afterwards the Government will come around and recheck our books and at that time we will know what the stock is worth, and we will know if the notes are going to be paid or not, and if the stock is worth $10 a share, then we are willing to pay income tax on it.' That was about my conversation with Thackaberry." (R. 1149, 1150.)

Robert McKeon's testimony respecting his explanation to Thackaberry of what was to be done with the 2,500,000 shares is as follows:

"At that time I told Thackaberry that two and a half million shares of stock had been tentatively set aside to be used by John for the enlargement or promotion of the Italo Company or for other reasons. I was not very definite with him as to what that would be used for. At that time we had put the stock up in escrow to remain for 90 days or as much time as was necessary, in order to give

> the brokers an opportunity to finance the syndicate and the company, and the escrowing of the stock was one of the things that we had agreed to do with the San Francisco brokers when they came down here and took charge of the financing and Vincent went out of the company. I told Thackaberry about that, and that was another reason that that stock might have to remain in escrow for six months or longer. There was really no way as far as I could see that you could do anything but get the least possible value on the stock until some future time when you knew what it was going to be worth and what you might realize on it." (R. 1150-1.)

Thackaberry then brought Lyons in to work the matter out as an accountant, and it was not until early in 1929 that Robert McKeon again heard about the matter. (R. 1151.)

During the course of his employment, Lyons prepared two documents, U. S. Ex. 87a and 87b. (R. 311-3.) These documents were prepared by Lyons for use in connection with the preparation of the federal tax return of the McKeon Drilling Company for the year 1928. (R. 1102.) With respect to the stock consideration being received by the McKeon Drilling Company in the preparation of these exhibits, Lyons assumed that the stock which the McKeon Company was receiving as part consideration for its properties was 2,000,000 shares and not 4,500,000 shares (R. 312), and in estimating the profit which the McKeon Company would have to pay upon the transaction, he eliminated from consideration the 2,500,000 shares which the McKeon brothers had agreed should be utilized

for the benefit of Italo, as well as for the other purposes heretofore mentioned and fixed the net profit to the McKeon Drilling Company at "$1,023,929.93". (R. 311-2.) Upon the document thus prepared by Lyons appeared the following statement:

> "Contract further provides for payment of ten notes of $50,000 each, maturing monthly starting Nov. 15, 1928, and provides for the payment of Italo stock to the extent of 4,500,000 shares, of which some 2,500,000 shares are payable as commissions, leaving 2,000,000 shares as additional consideration to McKeon Drilling Co.
>
> However, as the financial statement of Italo is uncertain and as it is not definitely known that the full consideration will be paid, and as the market value of the stock is a fictitious value based upon local supply and demand and is not a criterion of the real value of the stock, which value could not possibly stand the strain of absorbing the block of stock which is payable under the contract, it is the belief of the management of this company that only such profits as result from the excess of cash received over costs should be taken into profit and loss." (R. 313-4.)

In detailing the circumstances under which these documents were prepared, Lyons testified:

> "About the time I completed my work which is embodied in Exhibit 87-A, I had a talk with Mr. Thackaberry about further accounting work to be done. Thackaberry asked me to do some further work in connection with advising him as to how the whole transaction should be set up on the books. That is the Italo transaction, the sale of the assets to the Italo, with respect to the method

they would return their income, compute their income tax later on in the year when it would be necessary. Mr. Thackaberry told me that the total consideration to be received by the McKeon Drilling Company, according to this contract, was $500,000 in cash, $500,000 in notes and $500,000 in liabilities to be assumed, *and 4,500,000 shares of stock,* of which he stated to me only 2,000,000 shares were to be included in the income of the McKeon Drilling Company, and that in making this tax computation I was to make it on the basis of 2,000,000 shares only. He did not tell me why only 2,000,000 shares was to be included in the income tax statement. I got all of my information in regard to the work that I was to do from Mr. Thackaberry. I do not remember any one of the McKeons talking to me about it." (R. 1102.)

As to why he used the word "commissions" in connection with the 2,500,000 shares, he said:

"I do not remember exactly whether I arrived at the statement as to commissions from what Mr. Thackaberry told me or from my own conclusions as to the effect of the transaction that was detailed to me by him, but I think Mr. Thackaberry referred to it as commissions. I know that the contract does not provide for any commission. * * *

That reference to the full consideration will not be paid was talked over between Mr. Thackaberry and me. I understood that to be a fact at that time. It was also considered by Mr. Thackaberry and me that the stock involved was escrowed and placed beyond the authority or ability of the McKeons to obtain it at that time. Thackaberry told me they didn't have the stock, and I remember him saying it was in escrow." (R. 1104-5.)

And after testifying to the basis at which the value of the Italo stock was arrived, he further testified:

> "I was not informed as to why the 2,500,000 shares of stock was not at that time retained or what was to be done with it.
>
> With reference to the commissions referred to in the statement, to the best of my recollection Mr. Thackaberry referred to it in that way, and we were only concerned at that time with making this computation for the tax. I had in mind the fact that only 2,000,000 shares of the stock was to be retained, and that *2,500,000 shares was* to be devoted to some other purpose." (R. 1106.)

As to the purpose sought to be accomplished by him, he said:

> "In arriving at the result for taxation purposes, I considered a number of different elements. As a matter of accounting for tax purposes, all money that comes to a man or to a corporation is not taxable income. I was endeavoring to arrive at an equitable adjustment of the transaction for income tax purposes upon the basis of the information that Mr. Thackaberry had given me." (R. 1103.)

That the documents prepared by him were not final as far as the McKeon Drilling Company was concerned is further shown by this witness' testimony as follows:

> "I knew that that summarization could be used for the purpose of making entries on the books of the company unless they changed their mind before the end of the year or before they filed their income tax return." (R. 1106.)

Mr. Thackaberry was a witness called on behalf of the Government. Upon the question as to the status of the 2,500,000 shares of stock, he said:

> "I did not receive the information that 2,500,000 shares were commissions from any person. As far as commissions are concerned our first reaction to the matter was the tax matter, and the information that I received was that we were to receive 2,000,000 shares of stock only. Thereafter we treated the contracts, as far as our entries were concerned, and as far as taking care of taxes, as only 2,000,000 shares." (R. 322.)

Robert McKeon knew nothing whatever about the statement and computation made by Lyons until early in 1929. (R. 1151.)

Result of merger and subsequent activities spelled financial ruin to McKeons.

When the McKeon Drilling Company turned its properties over to Italo, it transferred an enterprise of great value, producing in net profits approximately in excess of $1,000,000 per annum. (R. 1206.) John McKeon, as general manager of production of Richfield, was in receipt of a salary of $100,000 per annum. (R. 1215.) Robert McKeon was managing the business and operations of McKeon Drilling Company. (R. 321.) What the McKeon brothers were willing to do and actually did with the consideration received by them from Italo has already been graphically portrayed in those portions of the record to which reference has already been made.

The net result of their generosity, their efforts, their service, their loyalty to Italo and their later endeavor to bring into existence an organization which, because of its financial structure, would be impervious to assault, but which was frustrated by the world-wide economic depression, was the loss to them of practically all of their possessions. John McKeon was not only deprived of all of his properties and resources, including his home, but likewise of a position, due to his ability, paying him a princely salary. Robert McKeon had left to him the unsecured obligations of Italo, thus far uncollected. Briefly referring to this situation, John McKeon testified:

> "In the deal I was able to hold the properties until away into next summer without further payments. I got extensions, and I kept Dabney from selling any of the stock to reimburse himself, by giving him a mortgage on a very beautiful home I had, and I got further extensions by adding further security, and in the windup I lost the stock and lost the home and I paid Dabney, I think, fifty thousand in cash besides." (R. 1222.)

And as showing that the Italo did not participate in this loss, he further testified:

> "Any loss that was suffered in connection with any of these transactions where I gave away or transferred for a consideration or not any of this stock was not charged back to the Italo Petroleum Corporation of America. The Italo Corporation suffered none of the detriment that resulted by reason of our having lost control or ownership of that stock and my brothers and myself sustained that loss and bore it ourselves. The Italo Petro-

leum Corporation acquired all of the McKeon properties that were involved in this contract and some other properties, and they had and have title to all of it." (R. 1230-1.)

Wilkes characterizes the position of John McKeon as follows:

"The money that was spent by McKeon and myself on the reorganization of the Italo was all McKeon's money, although I was acting as his agent in handling it, when the final settlement came after the crash in the fall of 1929 it cost us over a million dollars. A million shares were put up to secure the note to Dabney Johnson which were lost and we had to pay a deficiency judgment of $250,000.

Jack McKeon lost a ranch which cost him in the neighborhood of $100,000; there was $10,000 paid to Dabney, $10,000 paid to O'Donnell and including the attorneys' fees, accountants' fees, engineers' fees and expenses, and one thing and another, it ran up in the neighborhood of half a million dollars. That was money that was derived from the sale of the stock received by John McKeon which had been paid to the McKeon Drilling Company by the Italo Petroleum Corporation of America in payment of the properties of the McKeon Drilling Company." (R. 740-1.)

Robert McKeon summarized his position as follows:

"I think that about all I got out of the deal was the money owing from the Italo Company to the McKeon Drilling Company, amounting to about $350,000 to $400,000, and I have not received that yet." (R. 1195.)

This sum represented the notes which had been taken by the McKeon Company at the time it turned its properties over to the Italo Corporation, surrendering the security of these properties, in order to prevent the bank and certain other creditors of Italo from enforcing payment of its obligations to them. (R. 1166-7.) The notes were acquired by Robert McKeon for his interest in the McKeon Drilling Company (R. 1195), and as above shown still remain unpaid. (R. 1195.)

Reputation of McKeons.

The history of John and Robert McKeon, their character, as well as their reputation in the business world, is attested by what has been shown in the preceding pages of this statement. Their excellent reputations, however, were shown during the trial by evidence which was neither disputed nor subject to dispute.

Ralph Arnold, who had known John McKeon for 25 years, and had observed his operations in the oil business, testified:

> "I consider him one of the best oil production men there is in the world today. I am familiar with his general reputation for truth and veracity and good character and honesty and it is away above the average. He has a reputation that his name is better than his bond, because the bond might depreciate, but I have never known Jack's name nor him to go back on his word." (R. 785.)

William C. McDuffie, who for a number of years was head of the production department for the Shell

Oil Company throughout the entire world, and since that time has been and still is receiver of the Richfield Oil Company under appointment by the United States courts, knew John McKeon since 1912 and had extensive business relations with him. He said:

> "I have always found Mr. McKeon to be honorable and upright in his dealings with me, and I have used him a great deal in drilling contract wells. During my business relations with Mr. McKeon I became familiar with his general reputation for truth, honesty and integrity in the community in which he lives, and so far as I have ever known that reputation has been excellent." (R. 1198.)

John J. Doyle and G. E. O'Donnell, engaged in the oil producing business, and George W. Walker, chairman of the executive committee of the Citizens National Bank, all of whom for many years had known and had business relations with both John and Robert McKeon, attested the excellent reputation of each of them. (R. 1198-1200.)

Read in the light of the proven facts, defendants' correspondence relating to revenue stamps innocuous.

The court will recall that prior to October, 1928, in order to enable Italo to comply with its commitments arising out of the purchases of property and preventing the loss of the Graham-Loftus properties, upon which a substantial part of the purchase price had already been paid, and to enable the syndicate to proceed successfully with the sale of its stock through

which Italo was to be financed, John McKeon endorsed obligations for Italo to the extent of $600,000, had indemnified Shingle, as syndicate manager, against loss to the extent of two million shares of Italo stock and had arranged to utilize sufficient of the McKeon Drilling Company stock to the extent of approximately 500,000 units for the purpose of taking care of the Vincent & Company shortage.

We have also commented upon the conferences that took place shortly thereafter and during the early part of October, 1928, between the three McKeon brothers, John, Robert and Raleigh, in which the entire situation was canvassed, and it was agreed that John McKeon could use up to 2,500,000 shares of McKeon Drilling Company stock for the purpose of protecting Italo and thereby likewise protecting the McKeon Company's interest in Italo and bringing into existence a larger organization adequately financed to take care of all current obligations.

After testifying to the details of the conversation (R. 1141-47) with respect to the agreement reached Robert McKeon testified:

> "So Raleigh and I agreed that Jack could use up to 2,500,000 shares of stock for that purpose. By that purpose I mean to enlarge the Italo and make a bigger company out of it. We did not know exactly how much it would take but we told Jack that he could use the 2,500,000 shares, that we would be perfectly satisfied for our end of it if the McKeon Drilling Company retained 2,000,000 shares for the purpose of enlarging the Italo or for his own purpose. He had some affairs that he wanted to straighten out, some real estate

> interests, and it was our understanding that he was to have the stock to do with as he pleased for his own affairs and for the affairs of Italo, including the matter of dealing with Perata and Masoni, the Vincent settlement and anything else that he thought it was necessary to do." (R. 1147.)

This conference was corroborated by John McKeon. (R. 1213-4.)

On October 26, 1928, for the reasons already disclosed all of the McKeon Drilling Company stock then consisting of 3,440,000 shares of common and 940,000 shares of preferred stock of Italo, were deposited in escrow with Shingle, Brown & Company for a period of ninety days, and for such additional time as might be mutually agreed upon. (U. S. Ex. 98, R. 328-9.)

This escrow terminated on January 24, 1929. Before its termination—as has already been shown—orders had been signed directing the delivery of the stock then remaining in escrow. In connection with the distribution of this stock it became necessary for Shingle, Brown & Company, as escrow holders, to affix to the stock certificates revenue stamps which, with the revenue stamps previously affixed to the so-called Vincent stock, aggregated $954.94. Accordingly, on January 11, 1929, in anticipation of the distribution of this stock bills were sent by Shingle, Brown & Company to the McKeon Drilling Company, together with a communication in which it was stated, among other things:

> "This stock will be transferred into the names in accordance with the enclosed bills, and upon

receipt of the stock will be forwarded to them by registered mail. * * *" (U. S. Ex. 111, R. 341-2.)

On January 22nd, Thackaberry, on behalf of the McKeon Drilling Company, responded to the above communication as follows:

"We are in receipt of your bill for $954.94 covering federal stamps on stocks. Does this cover the stamps for all of the four and a half million shares or just our part of it? We would be pleased if you would send us a little more detail covering this charge." (R. 342.)

On January 24, 1929, Shingle, Brown & Company, through L. J. Byers, replied to this communication as follows:

"In reply to your communication of the 22nd relative to our bill for $954.94 covering federal stamps. Please be advised that Shingle, Brown & Company originally received in escrow 3,500,000 shares of common stock and a million shares of preferred stock in the name of Maurice C. Myers as trustee. We have delivered 60,000 of each classification to Maurice C. Myers in accordance with the escrow instructions, which left a balance of 3,440,000 shares of common and 940,000 shares of preferred on hand which we have transferred from the name of Maurice C. Myers, trustee, to the McKeon Drilling Company.

The transfer stamps on this stock on the basis of 2¢ per $100 was $876. Later it was necessary to deliver to Frederick Vincent & Company 198,735 shares common stock and 196,035 shares preferred stock on which the transfer stamps amounted to $74.94 which, combined with the

above mentioned charge of $876, makes a total amount due us of $954.94." (R. 342-3.)

On February 19, 1929, the McKeon Drilling Company, by Robert McKeon, communicated with Shingle, Brown & Company as follows:

> "The McKeon Drilling Company has a bill from you for something in excess of $900 for revenue stamps which were used on certain Italo stock. Would it be possible for you to send us the amount used on the various stocks issued to certain individuals from our escrow so that we can either bill them for their share or have you do so." (U. S. Ex. 15, R. 335-6.)

To which Shingle, Brown & Company, by Byers, responded as follows:

> "We wish to acknowledge receipt of your communication of the 19th relative to the bill of the McKeon Drilling Company for $954.94 due Shingle, Brown & Company for federal stamps. Please be advised that we are of the opinion that this charge cannot be passed on to the parties who received the stock from the escrow account *inasmuch as it is the customary ruling in stock transactions for the seller to pay for the federal stamps and not the purchaser.*" (R. 343.)

To this letter the McKeon Drilling Company, by Robert McKeon, under date of March 11, 1929 (U. S. Ex. 116), sent the following communication:

> "There has been a good deal of discussion between this office and yours with respect to bill for $954.94 for revenue stamps covering all the stock that was issued in the name of McKeon Drilling Company.

> Enclosed herewith is our check for $400 in payment for revenue stamps on 2,000,000 shares that were actually received by the McKeon Drilling Company. As you are aware, the balance of the stock was placed in account of McKeon Drilling Company only for the convenience of other interested parties. Therefore, we must decline to pay the revenue stamps on this stock. Each of the parties interested should pay for stamps on that proportion of the stock which he received." (R. 336.)

That considering the established facts there is nothing in this correspondence at all antagonistic to the innocence of the defendants must be obvious. But as already pointed out the 4,500,000 shares of stock belonging to the McKeon Drilling Company was transferred from the name of Maurice C. Myers, as trustee, into the name of McKeon Drilling Company at the time of the creation of the escrow, viz., October 26, 1928, and after it had been agreed that up to 2,500,000 shares thereof should be utilized for the purposes indicated.

Under these circumstances the McKeon Drilling Company rightfully objected to being charged for the revenue stamps which were to cover the stock to be utilized for the benefit of Italo, including its reorganization into a larger enterprise. That this was the basis upon which this correspondence proceeded is shown by the testimony of Robert McKeon, wherein he states:

> "I have a copy of Exhibit 116 among my papers. I am familiar with the letter written

by myself to Shingle, Brown & Company concerning certain revenue stamps on certain stocks. The letter is dated March 11, 1929, and is Exhibit 116. When we put our stock in escrow with Shingle, Brown & Company on October 26th, prior thereto when Shingle-Brown and the other brokers agreed to underwrite and take the underwriting of the syndicate stock or financing of the syndicate, they insisted that our block of stock be placed in escrow. They found that the International Securities Company had been selling some stock which we agreed to hold for them out of our block at a reduced price, and they had insisted that our block of stock be gotten out of the way so that it could not be offered for sale until after they had completed the financing of the syndicate. I said, 'Well, let's just leave it here with Myers, it is in his hands, and we have not called for it and we won't call for it until such time as you are through'. They said, 'No, it should be tied a little tighter than that. It should be placed in escrow'. I said, 'That will be perfectly satisfactory to me, we will place it in any bank that you say'. They said that there were two reasons really why a bank is not the best place to escrow it. The first is that it will cost considerable money to escrow that large block of stock, and that was not so much of an item to ask, but it was something, but the other reason was this: they said, 'If you put it into a bank, on some certain day that escrow will expire. We propose to sell our stock through brokers and there will be many speculators buy the stock or sell short against the stock, and it will undoubtedly leak out the day that this escrow will expire, and that this big

block of stock will continually be overhanging the market. We will take it and escrow it ourselves, hold it in our care, and won't charge anything, and no one need know the date it is coming out or anything about it'. So I agreed to that, but I said, 'In the event that takes place, I want the stock immediately transferred into the name of the McKeon Drilling Company'. Up to that time the stock as delivered to us was all in the name of Maurice C. Myers, in certificates of different denominations. They were endorsed by Myers as trustee, and it had been decided by then that Shingle-Brown were going to get some of the stock, that Perata and Masoni were going to get some, and that Vincent was going to get some, and various other persons, and it was discussed whether or not we would keep it in that condition, but I insisted that they were not to get any stock until they had fully performed the services that they were expected to perform, that is, Shingle-Brown were not to get any until they had financed the syndicate and had fulfilled the obligations of the syndicate to the company. So I said, 'We will have this all changed into the McKeon Company's name and then I will know it is safe there, that nobody is going to get their hands on it until such time as we decide it is time for them to have it'." (R. 1153-5.)

It was after the discussion just referred to that the stock was transferred into the name of the McKeon Drilling Company. (R. 1155.) That Robert McKeon should become indignant because of this charge can be readily understood. It is reflected by his testimony. He had been ill and shortly after his return from Honolulu, where he was convalescing, his attention

was called to the correspondence respecting revenue stamps amounting to some $900. After looking through the correspondence he wrote U. S. Exhibit 116. With respect to the reasons persuading this writing he states:

> "I had known that two and a half million shares of it (Italo stock belonging to McKeon Drilling Company) had been used or donated by the Drilling Company, and that some men had gotten it direct without any cash payment to the Drilling Company other than whatever indirect service might have been valuable to the Drilling Company, and I was a little provoked about it. I thought here Shingle-Brown had gotten half a million shares of this stock, Perata and Masoni had gotten another half or quarter of a million shares, which we had given to them, or the Drilling Company had, and, by George! they at least ought to be willing to pay the stamps on it. I said, 'That is carrying things just a little too far, to come back and want me to pay the stamps on this stock', so I sat down and wrote this letter to Shingle-Brown and in it I said, 'As you are aware, the balance of the stock was placed in the name of the McKeon Drilling Company only for the convenience of other interested parties'. I meant by that language that I was aware that it had been placed there and eventually had come into other persons' hands, and I really should have used 'inconvenience of other parties' because that stock was placed in the McKeon Drilling Company's name to be held safely and to be used only if those persons who were to get it were to help put the Italo over and help Jack on the final merger of the larger properties. That is what I meant by that letter." (R. 1156.)

Conclusion of statement.

We have endeavored throughout this statement to furnish the court with a true picture of the record. While the quotations are principally from the testimony of the defendants' witnesses, this course was necessary because the Government in the main relied almost entirely upon record evidence and inferences therefrom, which, in the absence of explanation, it claimed could be indulged in. The Government's points, however, are not glossed over, but on the contrary, the pertinent portions of its exhibits and the testimony of its witnesses are both discussed and quoted.

In our opinion this statement will be found to be a full and fair analysis of the evidence, as disclosed by the entire record, and it is our hope that it will be helpful to the court, in understanding the case in its entirety, and in giving consideration to the legal propositions which will be presented to it for its determination.

LAW ARGUMENT.

I.

PREJUDICIAL ERROR PRESUMED WHERE APPELLANTS DEPRIVED OF SUBSTANTIAL RIGHTS.

As will be hereafter pointed out, many rulings were made by the trial court, which completely disregarded the substantial rights of the defendants. Before proceeding, however, to a discussion of the legal propositions upon which the appellants John and Robert McKeon rely on this appeal, we believe it proper to call this court's attention to some of the recent decisions with which it is undoubtedly familiar, which require the reversal of judgments in cases wherein, even in solitary instances, defendants have been deprived of their substantial rights by a violation of the rules governing the admission and rejection of evidence.

We are pursuing this course because for a period following 1919, decisions were rendered by the Circuit Courts of Appeal in other districts, which were apparent authority for the proposition that, where a trial court committed an error in the introduction or rejection of evidence, the burden was cast upon the unsuccessful litigant to establish, by a consideration of the entire record, that the error was prejudicial.

These decisions, however, have been deprived of their authority as precedents by the decision of the U. S. Supreme Court in the case of *Williams v. Great Southern Lumber Co.*, 277 U. S. 19; 72 L. Ed. 761, 767. The action was brought by the widow of a colored man against the members of a so-called "vigilance committee" to recover damages for the killing of her

husband, which had occurred during a controversy between labor unions. Plaintiff complained that a conspiracy had been entered into between the lumber company and the remaining defendants to create a mob, the members of which, under the guise of a peace posse, were to kill plaintiff's husband. The homicide occurred during an attempted arrest of the deceased. Over the objections of defendant, the trial court permitted plaintiff to testify that about fifteen minutes after the killing, one of the volunteer policemen said that "They had come to kill Lem Williams". The court held that the statement was improperly admitted, because it was made after the conspiracy had accomplished its purpose. In reversing the judgment, the court, in commenting upon the question as to whether the error justified the reversal, said:

> "Since the passage of this act (Judicial Code, 269, as amended) as well as before, an error which relates, not to merely formal or technical matters, but to the substantial rights of the parties 'is to be held a ground for reversal UNLESS it appears from the whole record that it was harmless and *did not prejudice* the rights of the complaining party'." (Italics ours.)

The above language appears first in the words of Justice Stone in the case of *U. S. v. River Rouge Imp. Co.,* 269 U. S. 411, 70 L. Ed. 339, 346, and is there prefaced by a statement which recognizes the earlier conflict of decisions of various Circuit Courts of Appeal, in the following words:

> "We need not enter upon a discussion of the divergent views which have been expressed in

various circuit courts of appeal as to the effect of the Act of 1919."

In *Vicksburg v. O'Brien,* 119 U. S. 99, 30 L. Ed. 299, 300, it was held that an error entitles the aggrieved party to a reversal unless it appear so clear as to be beyond reasonable doubt that the error *did not and could not* have prejudiced the parties' rights.

See also:

Deery's etc. v. Cray, 5 Wall. 795, 18 L. Ed. 653, 657.

In the case of *Coulston v. U. S.,* 51 Fed. (2d) 178, 182 (10th Circuit), the judgment was reversed on the ground that the prosecuting attorney overstepped the bounds of cross-examination of the defendant. The appellee argued that

"the jury convicted upon abundant evidence and that the errors complained of were not prejudicial."

In answering the argument, the court said:

"The same contention was made to the Eighth Circuit Court of Appeals many years ago, and in response thereto that court (Sanborn, Van Devanter, and Philips sitting) said: 'The zeal, unrestrained by legal barriers, of some prosecuting attorneys, tempts them to an insistence upon the admission of incompetent evidence, or getting before the jury some extraneous fact supposed to be helpful in securing a verdict of guilty, where they have prestige enough to induce the trial court to give them latitude. When the error

is exposed on appeal, it is met by the stereotyped argument that it is not apparent it in anywise influenced the minds of the jury. The reply the law makes to such suggestion is: that, after injecting it into the case to influence the jury, the prosecutor ought not to be heard to say, after he has secured a conviction, it was harmless. *As the appellate court has no insight into the deliberations of the jury room, the presumption is to be indulged, in favor of the liberty of the citizen, that whatever the prosecutor, against the protest of the defendant, has laid before the jury, helped to make up the weight of the prosecution which resulted in the verdict of guilty'.''* (Italics ours.)

The latest decision on the point.

In addition to the clear definite expression of the Supreme Court on the point, we find the rule, comprehensively discussed and exactly defined, in one of the latest Circuit Courts of Appeal decisions, that of the tenth circuit in the mail fraud case of

Little v. U. S., 73 Fed. (2d) 860,

in which there was before the court the error of the trial court, in permitting the court reporter to read parts of the record to the jury in the absence of the defendant. The rule was there invoked, in answer to the District Attorney's contention that the error was harmless. The court recognized, as did the Supreme Court in the *Williams* and *River Rouge* cases (supra), that there were decisions rendered since the amendment to Section 2692 of the Judicial Code, holding that the burden rested upon the appellant to

"establish affirmatively both substantial error and resulting prejudice".

But it then calls attention to a number of cases following the amendment, in each of which

"a verdict was set aside because it did not *affirmatively appear* that no prejudice resulted from the error"

and then adds:

"No case has been cited, before or since the amendment, where substantial error occurred which, within the range of a reasonable possibility may have affected the verdict, where the appellant was required to prove that it did influence the jury." (866.)

For, said court, the

"appellant is not required to explore the minds of the jurors in an effort to prove that it did in fact influence their verdict."

It would be an anomaly if the prosecution in a criminal case could violate the constitutional rights of an accused for the purpose of securing a conviction, and would then be permitted to urge in support of such conviction that the error was not prejudicial.

II.

THE COURT ERRED IN PROCEEDING WITH THE TRIAL AFTER THE PRESENTATION AND FILING OF THE AFFIDAVIT OF PERSONAL BIAS AND PREJUDICE VERIFIED BY DEFENDANT SIENS AND JOINED IN BY THE DEFENDANTS JOHN AND ROBERT McKEON AND OTHERS (Assignment of Error No. 4, R. 1192.)

Prior to the trial of this action objection was made by certain defendants, including John and Robert McKeon, to the action being tried before Hon. Geo. Cosgrave, upon the ground that he had a personal bias and prejudice against them and in favor of the Government, and was therefore legally disqualified from presiding at the trial. In support of such objections, a detailed affidavit, verified by defendant Siens and accompanied by the certificate of the attorneys for the objecting defendants, including John and Robert McKeon, was filed. (R. 166-86.) At the conclusion of the hearing based upon the affidavit, Judge Cosgrave denied disqualification, and directed that the trial proceed before him, which was the procedure pursued.

A consideration of the affidavit will readily establish that the action of the lower court in this respect constituted highly prejudicial error which in and of itself entitles the defendants to a reversal of the judgment entered against them.

The code section.

The pertinent portions of Sec. 21 of the Judicial Code read as follows:

> "Whenever a party to an action * * * civil or criminal, shall make and file an affidavit that the judge before whom the action * * * is to

he trial * * * has a personal bias or prejudice against him or in favor of the opposite party to the suit, such judge shall proceed no further therein, and another judge shall be designated * * * Such affidavit shall state the facts and the reasons for the belief that such bias or prejudice exists. * * *"

(U. S. C. A., Title 28, Sec. 25.)

The affidavit.

The facts and reasons for the belief of the defendants that bias and prejudice existed in the mind of the trial judge are prefaced in the affidavit by the following statement:

"That affiant believes and alleges that the said district judge, the Honorable Burke Cosgrave, before whom this action is now pending, has a personal bias and prejudice against him and his co-defendants, John McKeen, Robert McKeen and R. B. McKeen * * * and each of them, and in favor of the government, by reason of which * * * neither of these defendants can have a fair and impartial trial before him." (R. 167.)

The facts and circumstances which persuaded such belief as disclosed by the affidavit are substantially as follows:

The water proceedings against receiver of "Lake"

That for some time prior to January, 1928, the defendants McKeen operated the McKeen Drilling Company, Inc., and the McKeen Oil Company, and in 1928 employed one Ray Carpenter as attorney for

the corporations at a salary of $1000 per month; that between January, 1929, and November, 1930, they paid Carpenter $34,946.48; that thereafter Carpenter was appointed receiver in equity of Italo Petroleum Corporation of America; that subsequently ouster proceedings were filed against him because of his connection, as attorney, with the McKeons and their corporations, but that Carpenter successfully resisted the ouster by his affidavit denying the relationship, and that he still remains as receiver (R. 168-169); that since the ouster proceeding said Carpenter

> "has manifested and still is manifesting an animosity toward the said defendants McKeon and on many occasions used his information and knowledge of the business affairs of said McKeons and their corporations to further his position as receiver. * * *" (R. 169.)

The injunction suit against McKeons, charging conspiracy.

That as receiver, the said Carpenter instituted a suit in the District Court of the United States, for the Southern District of California, Central Division, against a number of defendants including the appellants McKeon, and that in these said proceedings which fell before the Honorable George Cosgrave, judge of said court, the attorneys representing said Carpenter stated in open court that

> "Robert S. McKeon is the greatest conspirator of them all against the Italo, and I can prove it." (R. 170.)

That the statement so made was prompted by false information and that the

> "charge of conspiracy contained in said statement against Robert S. McKeon and the other defendants herein was believed and it had, as a statement of fact, an influence upon the judicial conduct of the said Judge Cosgrave, for * * * the injunction as prayed for was issued by said court and * * * made permanent." (R. 170.)

That in the complaint so filed by said Carpenter it was alleged in substance upon information and belief

> "that the persons named in the indictment herein as defendants in said action unlawfully conspired, confederated, schemed and connived to cheat and defraud the Italo Petroleum Corporation out of divers sums of money etc." (R. 171.)

and that such defendants, who were officers or agents or attorneys for said Italo Petroleum Corporation, conspired to purport to act for the corporation, but that they did in fact act on behalf of themselves in consummation of the alleged fraud, and conspired to

> "fraudulently, unlawfully and secretly take and appropriate etc. * * * large sums of money, property, etc. * * * of said Italo Petroleum Corporation" (R. 171)

and that in pursuance of said fraudulent design, they agreed to direct the purchase by the said Italo Petroleum Corporation from McKeon Drilling Co., Inc., of certain of its assets referred to in said complaint, *and that the transactions referred to therein were the same transactions as were referred to in the indictment herein.* (R. 171-172.)

Complaint in injunction case "re" reports of government agents.

And after describing further allegations of Clay Carpenter in said complaint, in which Carpenter stated that he had been permitted to peruse portions of a certain report made by the Department of Justice of the United States covering the activities of a number of persons and corporations including appellants (R. 172) and that from said report he was advised

> "of facts indicating that secret profits had been taken and received by persons, firms and corporations, the exact identity of said persons being undisclosed and unknown to said plaintiff." (R. 173);

It is asserted upon information and belief, that the report referred to by said Carpenter was the report of the Post Office Inspectors of the United States of America and the accountants of the Bureau of Investigation of the Department of Justice

> "who were assigned to the investigation and prosecution of the indictment of this case, and that said reports purport to contain a statement of the facts and evidence upon which the government expects to rely for the prosecution of the indictment." (R. 173.)

Judge James prejudiced, and such prejudice transmitted to Judge Cosgrave.

The affidavit then proceeds to state: that the facts of the relationship of attorney and client, between said Carpenter and the McKeons and their corpora-

tions, together with Carpenter's denial of such relationship, were communicated to the Hon. William P. James, judge of said court by a letter from one Richard Powers, an attorney at law, and that Judge James thereby became so prejudiced against McKeon and their associates in the Italo Petroleum Corporation, that Carpenter

> "was and still is able to forestall any action that the said Judge James might have taken or will hereafter take," and that Judge James, by such false and distorted statement of fact, and by Carpenter's indicating to said judge that he was without blame and is being persecuted, has become prejudiced, and that that prejudice "amounts to personal bias and prejudice of said Judge James * * * and that the said prejudice now abides in the mind of said Judge James against these defendants and that such personal bias and prejudice has been communicated by said Judge James to said Judge George Cosgrave and for that reason, among others, this affiant believes that the said Judge Cosgrave has a personal bias and prejudice against this affiant and his co-defendants and against their joint and several defenses." (R. 173-174.)

Government agents' comment on Judge James' attitude.

That the Government officers engaged in the investigation and prosecution of this case have stated that

> "if it had not been for Clay Carpenter, acting through Judge James, the 'Italo case' meaning thereby the present proceeding, would not be going to trial at the present time and might not go to trial at all." (R. 174.)

Divet employed by McKeons, and takes up case. J. F. T. O'Connor becomes Comptroller of Currency.

That Neil S. McCarthy, one of the attorneys in this proceeding for the McKeons, on April 13, 1933, discussed the date of trial with Judge James and requested a continuance because he (McCarthy) was not going to take an active part in the trial and that it had been arranged for J. F. T. O'Connor to try the case for the McKeons, but that O'Connor was considering accepting the position of Comptroller of the Currency of the United States; that O'Connor would not accept the appointment if sufficient time were not allowed for other counsel to prepare the case which involved a great amount of work, but that Judge James insisted that the cause be tried during the then term of court. (R. 175.)

Rumor of political intrigue in case passed on to Judge Cosgrave.

That McCarthy stated he had no objection to that, but desired the cause set for June 6th

> "in accordance with the agreement with the Attorney General".
>
> "Then Judge James stated to the effect that the case was in Judge Cosgrave's department and he would not interfere with it, except that he, Judge James, wanted it tried during this term. Judge James stated that statements had been made to him that it was planned through political influence to have the trial of this case postponed and finally disposed of. He stated also that it had been stated to him that the McKeons had stated that they were going to have Carpenter removed

as receiver of the Italo Corporation." (R. 175-176.)

That Carpenter had urged Judge James that the trial of the case be had at the earliest possible time

"and affiant further believes that the aforesaid information received by the said Judge James has been by said Judge James related to the Honorable George Cosgrave, judge of the above entitled court,"

and by reason thereof the said Judge Cosgrave has a personal bias and prejudice against affiant and his codefendants in favor of the prosecution. (R. 176.)

Judge Cosgrave believed story of political influence being sought.

That Judge Cosgrave then believed that defendants were using or attempting to use political influence to secure a dismissal of the indictment, and in addition received information as to alleged facts and circumstances connected with the transactions involved in the indictment resulting in personal bias and prejudice on his part. (R. 176.)

Conference in Judge Cosgrave's chambers.

That a conference was held in the chambers of Judge Cosgrave on or about May 2, 1933, at which the attorneys for the McKeons and the attorneys for other defendants, together with representatives of the United States Attorney General and the United States District Attorney were present, at which conference Judge Cosgrave was advised that O'Connor had accepted the appointment as Comptroller of the Cur-

rency, and that A. G. Divet was substituted in his place; that Divet had come from Washington D. C. where the Attorney General of the United States had advised him that the case would not be tried prior to June 6, 1933. (R. 177-178.)

Judge Cosgrave repudiated Attorney General's agreement and accused defendants of improper motives.

That Divet stated to Judge Cosgrave that he had accepted the employment because of this understanding with the Attorney General; that the Special Assistant Attorney General, James Wharton, also informed Judge Cosgrave, that he had been but recently assigned to the case; that he understood the case was not to be tried until June 6th, but he could be ready if it was continued for one week to May 23 (R. 178); that the said Judge Cosgrave

> "thereupon intimated that there was some irregularity or improper motive in Attorney Divet acting as counsel for any defendants in the case, by reason of the fact that he, the said attorney Divet, had formerly been a member of the staff of the Office of the Attorney General of the United States; that he, the said Judge Cosgrave, believed that Mr. Redwine was qualified and competent to try the case; that he did not understand why it was necessary to send a special prosecutor to Los Angeles to try the case" (R. 178-179)

and that thereupon the said Redwine informed Judge Cosgrave that he had been removed from the case and had thereupon resigned as assistant United States Attorney. That then,

"The said Judge Cosgrave stated in substance and effect that he did not dare or would be afraid to continue the trial of the said case; that the request for the continuance of the trial of said case to June 6, 1933, was refused and that the said case would proceed to trial on May 16th." (R. 179.)

Judge Cosgrave biased against defendant.

That the reason for Judge Cosgrave's remark was that he

"had been informed in substance and effect that there had been political intrigue used by these defendants or some of them to have the trial of the said case postponed for an indefinite period of time" (R. 179),

and that

"Judge Cosgrave believed that the request * * * was being made as a part of said plan" (R. 179),

and that

"the information received by Judge Cosgrave has created in his mind a personal bias and prejudice against the defendants" (R. 179-180),

and further

"that by reason thereof none of the defendants herein could, or would, receive a fair or impartial trial before the said Judge Cosgrave" (R. 180),

and further

"that the said Judge Cosgrave is prejudiced and biased in favor of the plaintiff herein." (R. 180.)

May 9th meeting of counsel in Judge Cosgrave's courtroom.

That upon May 9, 1933, counsel for some of the defendants were requested to be present in the courtroom of Judge Cosgrave, at which time the case was called and Judge Cosgrave stated that he understood that there were matters to be presented to the court. That thereupon A. G. Divet, counsel for defendants McKeon, in the presence of the prosecuting attorneys said to the court that the Attorney General of the United States had entered into an agreement with J. F. T. O'Connor to the effect that if said O'Connor would accept an appointment to the position of Comptroller of the Currency of the United States, that the trial of this action would be continued to the 6th day of June, 1933, in order to permit the said A. G. Divet to take over the law practise of the said J. F. T. O'Connor and allow him sufficient time to prepare said case for trial. Had it not been for such agreement, O'Connor would not now be Comptroller of the Currency and Divet would not be in Los Angeles taking over O'Connor's law practice. That Divet stated to Judge Cosgrave upon his honor as a lawyer that he could not properly prepare the case by the time set for the trial and asked that the trial be continued until June 6th. (R. 180-181.)

That thereupon Judge Cosgrave stated that he understood the matter was brought up on the calendar to enable the attorneys to eliminate collateral or immaterial matter from the issues to save time, and that James Wharton, one of attorneys for the plaintiff said that he had been engaged in the investigation of and in familiarizing himself with, the case, and that he

expected to eliminate some of the evidence and dismiss the indictment as to some defendants, and he suggested the case be continued until May 23, 1933. (R. 181-182.)

Judge Cosgrave expresses lack of faith in veracity of counsel for defendants McKeon.

That Divet then stated that he would still need the additional time and Wharton said that he withdrew his objection to continuing the trial to June 6th. (R. 182.)

That

> "thereupon the said Judge Cosgrave stated in substance and effect that he was not impressed with the statement of counsel for defendants that he required at least until the 6th of June, 1933, to properly prepare the case for trial and properly represent his clients; that he thought that the trial of the said case could be, and should be, had at an early date, and that the time required for the trial thereof could be and should be materially shortened and stated that mail fraud cases walked like spectres through the courtroom and it was necessary to eliminate the fringes of the case in order to expedite the matter and that, in his opinion, the suggestion of the plaintiff that one week be allowed for this purpose was, in his opinion, justified, and he thereupon set the matter for trial as of May 23, 1933." (R. 182-3.)

Government agents desired case tried by judge friendly to prosecution. Transfer from Judge McCormick's Court to Judge Cosgrave's Court.

That affiant had just been informed that while this cause was pending before Hon. Paul J. McCormick, and during the trial of another case under the mail fraud statute, a government employee, engaged in the investigation and preparation for trial of this case said that they desired this cause to be tried before a "more friendly judge", meaning thereby a judge friendly to the prosecution, and that thereafter the cause was transferred to Judge Cosgrave, and for that reason also affiant believes that Judge Cosgrave had a personal bias and prejudice in favor of plaintiff. (R. 184.) That the government officers and employees who were interested in the investigation and prosecution of the *U. S. v. Showalter* case and also in an investigation and a prosecution of this case, said at the close of the *Showalter* case that if they had received more cooperation from the judge in said case, they would have convicted all of the defendants. Thereupon affiant stated his belief that by reason of this information, he believed that Judge Cosgrave is more friendly to the prosecution of such cases than Judge McCormick who was fair and impartial and that Judge Cosgrave would cooperate with the prosecution in the matter (R. 185); that judge Cosgrave in addition to having a personal bias and prejudice against the defendants and each of them "is personally biased and prejudiced in favor of the United States of America, the plaintiff herein, its officers and em-

ployes assigned to the investigation and prosecution of this case". (R. 185.)

Judge's ground for refusal to withdraw.

The trial judge in giving his sole ground for refusing to accede to the affidavit, said:

> "The affidavit is entirely lacking in facts that in any degree support a fair inference of bias and the trial will therefore proceed." (R. 188-9.)

That the matters set forth in the affidavit legally disqualified Judge Cosgrave from presiding at the trial must be conceded.

Functions of the trial judge in passing upon sufficiency of affidavit of prejudice.

It has been definitely established that a trial judge of a federal court, in passing upon an affidavit of prejudice addressed to him, must accept all of its statements as true, and that the only function which the trial judge can exercise, with reference to the subject matter of the affidavit, is to determine whether or not, assuming the facts stated as true, there is contained in the affidavit a statement of bias or prejudice.

Berger v. U. S., 255 U. S. 22, 65 L. ed. 481 (certified in the Supreme Court by C. C. A. 9th Circuit);

Nations v. U. S., 14 Fed. (2d) 507 (8th Circuit) (certiorari denied by Supreme Court), 273 U. S. 735, 71 L. ed. 866;

Chafin v. U. S., 5 Fed. (2d) 592, 593 (certiorari denied by Supreme Court), 70 L. ed. 407;

American Brake Shoe Company v. Interboro R. T. Co., 6 Fed. Supp. 215 (New York District Court).

The sole question to be determined by this court, therefore, is whether the matters alleged in the affidavit are sufficient to bring the case under the purview of *section 21, Judicial Code,* requiring the affidavit to show:

> "(A) That the judge * * * has a personal bias or prejudice either against him (defendant) or in favor of any opposite party (plaintiff)";

and (B)

> "the facts and reasons for the belief that said bias or prejudice exists."

The affidavit charges "that the judge has a personal bias or prejudice" against defendants and in favor of plaintiff.

In this regard the affidavit alleges:

> "that affiant believes and alleges that the Honorable Judge Cosgrave, before whom this action is now pending, has a personal bias and prejudice against him and his codefendants John McKeon, Robert McKeon, R. B. McKeon, * * * and other defendants, and each of them, and in favor of the government." (R. 167.)

And again:

> "This affiant believes that the said Judge Cosgrave has a personal bias and prejudice against this affiant and his codefendants and against their joint and several defenses and in favor of the government." (R. 174.)

The affidavit states the reason for the belief of the affiant as to the bias and prejudice of Judge Cosgrave.

It is, of course, impossible for a party litigant to read the mind of a trial judge for evidence of bias and prejudice against him. He is only required, therefore, to set forth in the affidavit the facts, upon which his opinion as to the judge's bias are based. Furthermore, the facts set up in the affidavit need not be alleged with the particularity of an indictment.

Nations v. U. S., 14 Fed. (2d) 507 at 509.

Three sets of facts charged.

The affirmations in the affidavit of prejudice as to these facts may be separated into three classes, viz.:

1. Those setting up the facts upon which is based affiant's belief that Judge Cosgrave has a personal bias and prejudice against the defendants;

2. Those stating the facts which caused affiant to believe that Judge Cosgrave was prejudiced in favor of the prosecution; and

3. Those which were offered for the purpose of establishing acts and conduct of Judge Cosgrave which demonstrated the existence of such bias and prejudice.

We will therefore address ourselves to the matters stated in the affidavit in the order stated.

I. **Facts alleged supporting affiant's belief that the trial judge was prejudiced against defendants.**

(a) That animosity arose in the mind of Clay Carpenter, Receiver of Italo Petroleum Corporation of America against the defendants and particularly against the defendants John McKeon, Robert McKeon and R. B. McKeon through conflicting affidavits made by Carpenter on the one side and by the McKeons on the other, in the ouster proceedings in which it was sought to remove Carpenter, as Receiver (R. 167-169);

(b) That thereafter Carpenter, as Receiver, filed an equity suit against the defendants herein to enjoin certain of the defendants, including Robert S. McKeon and others from disposing of notes secured by them from Italo Petroleum Corporation growing out of the sale of the property of the McKeon Drilling Co., Inc. to Italo Petroleum Corporation (R. 169-170);

(c) That in the court proceedings of said case which came before Judge Cosgrave, based upon a complaint *in which the same conspiracy was charged as was charged in the indictment before this court,* Carpenter's attorney stated in open court that:

> "Robert S. McKeon is the greatest conspirator of them all against Italo, and I can prove it."

and *that said statement* prompted by false information *was believed by Judge Cosgrave and influenced him in granting the injunction against the McKeons as prayed for.* (R. 170.)

(d) That in the said complaint filed by said Carpenter against the said defendants, Carpenter alleged

that he had had access to the report of the Department of Justice covering the activities of the defendants herein, and was there advised that secret profits had been taken, which charge was, of course, before Judge Cosgrave on the hearing of said injunction. (R. 172-173.) (The affidavit likewise states that the reports referred to in the pleadings in said action are the reports of the postoffice inspectors and Department of Justice investigators which were the basis of the indictment in this case.)

(e) That Carpenter by use of a letter written by one, Powers, an attorney at law, to Judge James of the same District Court, and by false and distorted statements of fact, and by intimating to Judge James that he was without blame and was being persecuted, created in Judge James' mind a prejudice against the McKeons and other defendants, and that the personal bias and prejudice of Judge James has been communicated by him to Judge Cosgrave, and that as a result affiant believes that Judge Cosgrave has a similar bias and prejudice. (R. 173, 4.)

(f) That Neil S. McCarthy, counsel for the McKeons in their defense against the indictment herein, was told by Judge James that the case had to be tried during the then term of court; that he would not interfere with Judge Cosgrave's handling of the matter, except that he wanted it tried during the then term because statements had been made to him (Judge James) that it was planned through political interference to have the trial postponed, and finally disposed of, and that he had been told that the McKeons

had stated that they were going to have Carpenter removed as Receiver. (R. 175-6.)

(g) That Carpenter had urged Judge James to in turn urge that a trial of the case be had at the earliest possible moment, which information was by him related to Judge Cosgrave, thereby creating in the mind of Judge Cosgrave a personal bias and prejudice against the defendants in favor of the plaintiff. (R. 176.)

(h) That Judge Cosgrave believes that the defendants or some of them have attempted to exercise or exert political influence, and that this fact has created in his mind a bias and prejudice against the defendants. (R. 176.)

II. Facts alleged in support of affiant's belief that the trial judge is prejudiced in favor of the prosecution.

(a) That this cause was first pending before the Hon. Paul J. McCormick, one of the judges of said District Court, and while so pending before him, an employee of the plaintiff, engaged in investigating the case and in preparing it for trial stated that the posecuting officers desired to have the trial before a more friendly judge, meaning a judge more friendly to the prosecution than Judge McCormick, and that thereafter the cause was transferred to the court presided over by Judge Cosgrave.

(b) That about the same time following the verdict in the case of *U. S. v. Showalter,* tried before Judge McCormick, government officers and employees engaged in the prosecution of this case stated that if

they had more cooperation from Judge McCormick in the *Showalter* case, they would have convicted all of the defendants. (R. 183.)

(c) That the government officers believed that Judge Cosgrave would cooperate with them in the prosecution of the defendants. (R. 185.)

III. Facts showing that Judge Cosgrave, prior to the filing of the affidavit, had shown bias and prejudice against the defendants.

(a) That upon the arrival of Divet in Los Angeles from Washington, D. C., to take the place of O'Connor, Judge Cosgrave was advised that the Attorney General of the United States had agreed with the said O'Connor that if O'Connor would accept the appointment of Comptroller of the Currency, he, the Attorney General, would stipulate to a continuance of the trial of said cause until June 6, 1933, to enable Divet to prepare himself therefore, but that in face of these facts and despite the further fact that the special representative of the Attorney General who came to Los Angeles to prosecute the case, and who himself required additional time, raised no objection to the continuance to June 6th, the trial judge refused to grant such continuance. (R. 177-9.)

(b) That at a conference held in Judge Cosgrave's chambers on May 2, 1933, Judge Cosgrave intimated that there was some irregular or improper motive in Attorney Divet acting for the defendants, because he had been formerly a member of the Attorney General's staff, and also that he, Judge Cosgrave did not

see why the local Assistant United States Attorney could not try the case without help of a special Assistant Attorney General, and that he, *Judge Cosgrave, "did not dare, or would have been afraid to continue the trial of the case".* (R. 179.)

Argument and authorities.

There is nothing in the Judicial Code section, nor in the language of the decisions interpreting the same which requires, that an affidavit of prejudice, furnish actual acts of prejudice upon the part of the trial judge. But we believe that the affiant in this case, in relating what transpired in Judge Cosgrave's chambers, was alleging acts and conduct upon the part of the judge, which did in fact show bias and prejudice. It seems inconceivable to us that any judge who resented the employment of a special Attorney General to prosecute the case (which is a common practice), who resented the fact that a former Assistant Attorney General, having had no connection with the controversy in which he was employed was defending the case; and who stated that he didn't dare continue the case, could possibly be in possession of a mind sufficiently free from prejudice or bias to have enabled him to accord defendants a fair and impartial trial.

In overruling defendants' objection to his proceeding with the trial, Judge Cosgrave asserted that the affidavit in effect merely charges that he had made an adverse ruling against some of the defendants in a preliminary motion in a civil action. If this was all that the affidavit charged as evidence of prejudice, of course, the affidavit would have been insufficient. But

when consideration is given to the conceded fact that the ground upon which the court issued both its preliminary, as well as permanent injunction, *was the identical conspiracy charged in the indictment and that the court found against the defendants thereon,* it necessarily and logically follows that the court having passed upon the fact of conspiracy must have formed an opinion as to that fact, which would require evidence to remove. In other words, if the facts alleged in the disqualifying affidavit are true, Judge Cosgrave could not avoid entering upon the trial with a fixed opinion as to the existence of the conspiracy, which is the very basis of this action.

Judge Cosgrave further commented in his statement that the affidavit charged no expression of opinion on his part, other than his passing upon the preliminary motion. But it must be conceded that the expression of opinion of the trial judge, contained in an order made by him in a prior proceeding, is just as definitely an expression of opinion, and just as strong evidence of bias against the defendants, as though he had stated outside of court that, in his opinion, the defendants were guilty of a conspiracy to defraud. And if he uttered such a statement outside of the court, we do not believe that even Judge Cosgrave would contend that it would not have established the existence of bias and prejudice upon his part.

But Judge Cosgrave was in error, in stating that no further acts were charged in the affidavit. He overlooked entirely the recitation in the affidavit as to the happening in his chambers when, with the

attorneys for both sides present, he expressed dissatisfaction with the fact that the government was supplanting the local Assistant District Attorney in the case and criticised the defendants McKeon for employing a former Assistant Attorney General to represent them and voiced his *fear* of granting a continuance therein, despite the fact that the Attorney General of the United States had on behalf of the plaintiff consented to such continuance.

There are many cases in the books reversing federal trial courts for the failure upon the part of the judge thereof to recognize the virtue of an affidavit of prejudice filed against him. While the affidavits in many of the cases are closely analogous to the affidavit here under consideration, we believe that the affidavit held sufficient by the Circuit Court of Appeals of the Eighth Circuit in the case of

Nations v. United States, 14 Fed. (2d) 507,

in which the government's petition for a writ of certiorari was denied by the Supreme Court (273 U. S. 735, 71 L. Ed. 866), comes as near as any to being a counterpart of the Siens affidavit in this case.

Comparison of affidavit in Nations case with affidavit in case at bar.

The affidavit in the *Nations* case in its pertinent provisions read as follows:

> "the judge before whom this action is pending * * * has a personal bias or prejudice against him, and has a personal bias and prejudice in favor of the plaintiff, the United States of America, who is the opposite party to this action."

Affidavit in this case.

The corresponding statement in the affidavit in the case at bar is as follows:

> "has a personal bias and prejudice against him and his co-defendants (naming them) and in favor of the government" (R. 167)

but the statement in the affidavit in this case adds the following:

> "by reason of which said personal bias and prejudice * * * neither of these defendants can have a fair and impartial trial before him." (R. 167.)

In the *Nations* case the affidavit further asserted:

> "The facts and reasons for the belief that such bias and prejudice exists are as follows, to wit: He is informed and believes that persons connected with the United States government and having a special interest in this prosecution, have communicated to said judge what they allege to be knowledge of facts and circumstances connected with the transactions averred in the indictment, and that as a result of said communication the said judge has an ill and unfriendly feeling against said defendant, and has formed an adverse opinion as to the defendant's innocence, and now entertains the belief that there is no meritorious defense to the charge made against said defendant."

In the affidavit before this court for consideration, we find several statements which are analogous to the affidavit in the *Nations* case. They charge:

1. That an attorney stated in the presence of Judge Cosgrave that:

> "Robert S. McKeon is the greatest conspirator of them all against Italo, and I can prove it",

and that Judge Cosgrave in hearing said statement believed it and was influenced thereby in granting an injunction against the McKeons (R. 170);

2. That Carpenter, the Receiver of Italo Petroleum Corporation of America, made false statements of the facts in this case to Judge James, one of the judges of the said United States District Court, and that Judge James became thereby prejudiced against these defendants and communicated the false facts and prejudices to Judge Cosgrave, and created in Judge Cosgrave's mind a similar condition of bias and prejudice. (R. 173, 4.)

In the *Nations* case the affidavit further asserted that:

> "The defendant further says that he is informed and believes said judge has stated that it is his opinion and belief that this defendant has been and is guilty of having cooperated and conspired with others * * * to unlawfully give protection to * * * Griesedieck Bros. Brewery Company and other persons in unlawfully manufacturing, * * * intoxicating liquors in violation of the laws of the United States."

The affidavit before this court charges that in the civil action pending before Judge Cosgrave filed by said receiver, Carpenter, in which the said Carpenter sought an injunction against the defendants McKeon on the ground that they had engaged in the very conspiracy charged in the indictment now before this court, and with the issue as to whether or not such a conspiracy to defraud existed, Judge Gosgrave formed a fixed opinion and expressed that opinion in the form of an order granting a preliminary judgment on the

grounds set out in the complaint of said Carpenter, and that as a result thereof, Judge Cosgrave has a feeling of bias and prejudice against the said defendants in this case. (R. 170.)

We believe that the comparison just made of the affidavit in the *Nations* case, with the affidavit in this case, discloses that they cover exactly the same ground, and that the decision of the Circuit Court of Appeals in that case, by reversing the judgment of the trial court because the trial judge refused to give effect to the affidavit of prejudice filed therein, should be a safe precedent for reversal by this court of the judgment against defendants herein in the case at bar, because of the failure of Judge Cosgrave to recognize the validity of the affidavit accusing him of bias and prejudice. But the affidavit in the present case goes much further in its charges, by alleging that in a conference being had looking towards a continuance of the trial, Judge Cosgrave insinuated that the defendants were guilty of political intrigue, in endeavoring to have the trial of the cause postponed (R. 178-179); expressed doubt of the good faith of defendants' counsel Divet, in seeking a continuance of the case so that he might prepare himself for trial (R. 182-3) and intimated that there was something wrong because of the fact that the Assistant Attorney General was supplanting the local Assistant United States Attorney in the case, and that the former Assistant Attorney General was being employed by defendants to represent them in the case. (R. 178-9.)

It is submitted that it would be difficult indeed to find a case in which the facts proving prejudice and

bias are as many or as powerful as those appearing in the affidavit filed in the court below. That appellants are entitled to a reversal of the judgment appealed from, on this point alone, is clear from the following authorities.

Berger v. U. S., 255 U. S. 22, 65 L. ed. 481;
Nations v. U. S., 14 Fed. (2d) 507 (8th Circuit);
Chafin v. U. S., 5 Fed. (2d) 592, 593;
American Brake Shoe Co. v. Interboro B. T. Co., 6 Fed. Supp. 215.

The right of appellants to a change of judge under the circumstances revealed by the affidavit in this case is statutory. Section 21, *Judicial Code,* quoted hereinabove provides that upon the filing of a proper affidavit "the judge shall proceed no further". Obviously, therefore, where the trial judge arbitrarily disregards the affidavit filed and ignores the rights expressly granted the parties by that section, the appellate tribunal cannot by affirming his action, destroy the very intent and purpose of the Code section. As was said by the Supreme Court in

Berger v. U. S., 255 U. S. 22, 65 L. ed. 481,

> "Remedy by appeal is inadequate. It comes after the trial, and if prejudice exists it has worked its evil and a judgment of it in a reviewing tribunal is precarious."

In other words, as to the duty of the judge upon the filing of such affidavit the statute is (to quote from the decision in *Nations v. U. S.,* supra),

> "plain in its terms and imperative in its character."

III.

THE TRIAL COURT ERRED IN ADMITTING IN EVIDENCE OVER THE OBJECTIONS OF DEFENDANTS, PURPORTED RECORDS OF CORPORATIONS AND PARTNERSHIPS WITHOUT A PROPER FOUNDATION FOR THEIR INTRODUCTION.

The records in question with the appropriate transcript references to the objections made to their introduction, and the assignments of error in relation to their admission, are as follows:

1. Records of Italo-American Petroleum Corporation.

(Assignment of Error No. 24.) (R. 1405-7.)

(a) *Minute Books,* Exhibit 3. (R. 191, 192.)
Objections and ruling. (R. 192.)

(b) *Books of Account,* Exhibits 5, 6, 8 and 9. (R. 198-200.)
Objections and ruling. (R. 200-202.)

2. Records of Italo Petroleum Corporation of America.

(Assignment of Error No. 27.) (R. 1410-19.)

(Assignment of Error No. 28.) (R. 1419-23.)

(a) *Minute Books,* Exhibits 16-A, B and C. (R. 221-6.)
Objections and ruling (R. 222-27) and motion to strike and ruling. (R. 236.)

(b) *Book of Account,* Exhibits 28-A, B, C and D and 29, 31 and 33. (R. 255-261.)
Objections and ruling. (R. 261-264.)

3. **Records of Bacon & Brayton in account with Wilkes & Cavanaugh.**

(Assignment of Error No. 30.) (R. 1424.)

Photostatic copies of statements, Exhibit 58. (R. 284.)

Objections and ruling. (R. 284.)

4. **Books and accounts of Shingle, Brown & Co., a corporation, Shingle, Brown & Co., a co-partnership, and allied companies and partnerships.**

(Assignment of Error No. 37.) (R. 1437.)

(a) *Exhibit 183.* Account records of Montgomery Investment Company, a copartnership, consisting of Shingle, Brown, Mikel and Jones. (R. 448.)

(b) *Exhibit 184.* Account of Montgomery Investment Company with Shingle, Brown & Co. (R. 449.)

(c) *Exhibits 185, 188-226.* Account records of Shingle, Brown & Co. showing accounts with various concerns and corporations in which defendants McKeon were neither officers, stockholders or members and with various individuals not including any of the defendants McKeon. (R. 449-57.)

(d) *Exhibits 186, 187 and 227.* Books of account of Fred Shingle, Syndicate Manager. (R. 449, 457-8.)

(e) *Exhibit 228.* Ledger sheets of Shingle, Brown & Co. showing account called "McKeon Escrow Account". (R. 459.)
Objections to admission in evidence of foregoing exhibits. (R. 448; 450-1; 453-7; 459-60.)

5. Records of Brownmoor Oil Co.

(Assignment of Error No. 38.) (R. 1437.)

(Assignment of Error No. 43.) (R. 1444.)

(a) *Books of account,* Exhibits 32-A, B and 147. (R. 468-9, 368, 650.)
Objections and ruling. (R. 469, 650.)
Motion to strike and denial thereof. (R. 686, 689.)

(b) *Minute Book.* (Exhibit 239.)
Objections and ruling. (R. 560-1.)

Under another heading we will discuss the inadmissibility of these books and records regardless of their foundation. Here we are dealing exclusively with their admissibility upon the ground that no adequate foundation was laid for their introduction.

It is quite apparent from the record that the government entered into the trial of this action with the idea of establishing the existence of the purported conspiracy and to show the alleged concerted action of the defendants by books, records and other documents in order to lay the foundation for the introduction in evidence of the charts and summaries already prepared by the government's employee Goshorn and by the testimony of Goshorn and his fellow employee Hynes.

In another phase of this brief we comment upon the fact that the summaries prepared by Goshorn, based in part on the records here under discussion and in part upon his idea of what was necessary to secure a conviction, were of such colossal size as to give to the extravagant conclusions of Goshorn by whom they were prepared an emphasis to which they were not legitimately entitled.

If these books and records were inadmissible, no justification whatever would have existed for the admission in evidence of the summaries or the testimony of Goshorn or Hynes. Furthermore, if these books and records had not been admitted the government's case would have crumbled and disintegrated. With these considerations in mind, it will readily be concluded that none of these books or documents should have been admitted, unless the foundation legally required for their introduction was first established, and that their admission in evidence, in the absence of such foundation, violated the constitutional rights of the defendants, thereby demanding a reversal of the judgment of the court below.

An examination of those portions of the record to which reference will shortly be made, will convince the court that the government failed to properly lay the foundation for the admission in evidence of any of the books and records above described.

To demonstrate this proposition, as well as for the convenience of the court, we will call attention to the evidence, offered by the government as a foundation for the introduction of each of the exhibits referred to. It will be observed that in the case of many of these

exhibits the government did not even make a pretense of laying a foundation. Some of the exhibits were identified by bookkeepers and employees, hired long after the entries in the books were made. The government failed in every instance to establish, and in most instances, to even attempt to prove that the books and records introduced were properly kept or that the entries were correctly made, AND NO EVIDENCE WAS OFFERED OR ATTEMPTED TO BE OFFERED THAT ANY OF THE ENTRANTS WERE DEAD OR UNAVAILABLE.

The record discloses the fatal lack of evidence to permit the admission of the exhibits in evidence.

Exhibit 3, Minute Book of Italo-American Petroleum Corporation. These records were introduced for the purpose of proving minutes relating to a dividend purporting to have been declared in April, 1925. (R. 192.) They were identified by Courtney Moore, who testified that he became the attorney for the corporation *late in 1925* (R. 191) and that the minutes *in the book as of prior to December 28, 1925,* were copied from the original minute book and "various memoranda" furnished to him. (R. 191.) *No testimony was offered as to correctness.* The objection of defendants, that the foundation had not been laid, was promptly overruled. (R. 192.)

Exhibits 5, 6, 8 and 9. Books of Account of Italo-American Petroleum Corporation. These records were introduced during the testimony of *Ida M. Scettrini,* to form the basis for the testimony of the government accountant James F. Hynes. (R. 200, 1406.) She testified that she went to work for the corpora-

tion in February, 1927, and continued in such employment until August 1, 1930. (R. 198.) She identified Exhibit 5 (general ledger) purporting to show cash receipts *for the years 1926*-1929 inclusive. (R. 198.) She identified Exhibit 6 as a ledger made up from postings from other books and kept under her supervision; Exhibit 8 as another ledger, and Exhibit 9 as a trial balance for the years 1927-1929 prepared by her. (R. 199-200.) But not a word of testimony as to their correctness.

Exhibits 7, 10, 12, 13. Further account books of Italo-American Petroleum Corporation. These exhibits were identified by Emma Baldócchi, called by the government. She testified that she did bookkeeping for the corporation until February, 1927 (R. 203); that *Exhibit 12* was "one of the books" she handled, and that the entries therein were made by her or the public accountant employed by the company "in its usual course of business". (R. 204.) She further testified that the entries in Exhibit 12 from November, 1924, were made by her; that as to *Exhibit 13* the "financial record of Italo American Co." *the entries up to November, 1924, were in the book when she received it,* but that entries since then were made by her. *Exhibit 10* was identified by the witness in the same manner. She testified that the *entries made prior to November 24, 1924, were in the book when she received it,* and that she made the entries from that date to February 12, 1927. (R. 205.) Not a word with reference to the integrity of the books—nothing to indicate they were correct or even as to the identity of the person who made the earlier entries.

The above records in their entirety were used as the basis for the testimony of the government accountant J. F. Hynes. (R. 204-5.)

Exhibits 16-A, B and C. Minute books of Italo Petroleum Corporation. The government called Robert R. McLachlen to identify the exhibits. As to *Exhibit 16-A* he testified that it was "one of the minute books kept in the office of" the corporation and *covers the period from the organization to December 7, 1928;* that the *first entry he made was* in Volume 2 (Exhibit 16-B) *on April 18, 1929.* Without further preliminaries the court thus accepted the identification of the minute book, by a witness who never saw the book until long after the minutes were transcribed therein, and one who was not even an officer of the corporation during the period covered by the minutes. Exhibit 16-A was introduced in evidence over the strenuous objection of defendants. (R. 221, 226-7.)

As to *Exhibits 16-B and C,* the witness testified that *his first entry in Volume 2* of the minutes (Exhibit 16-B) *was on April 18, 1929,* and from then on he kept all the minutes except *"possibly two".* (R. 221.) When defendants objected to the introduction of Exhibits 16-B and C, the court took a hand in the laying of the foundation and we cannot more clearly establish the careless manner in which a foundation was attempted to be laid for the exhibits introduced, than to quote the exchange between the court and the witness and counsel, with reference to their introduction.

> "The Court. And were all of these minutes (referring to minutes from April 18, 1929) made by you, written by you?" (R. 224.)

"A. After the date that I designated there with the exception of *several*——

The Court. *Of one or two meetings?*

A. One or two meetings.

The Court. And you were the one that kept the minutes from that time up to when?

A. Up to the last few minutes.

The Court. Yes, the last minutes. Then, all the minutes from and after April 29 recorded in the books were kept by the witness?

The Witness. With the exception of——

The Court (interrupting). With the exception of *some of the minutes.* Do you identify them, Mr. Redwine?

Mr. Redwine. *I was going to identify the last group of them.*

The Court. *But you kept the minutes correctly?*

A. Yes, sir.

The Court. You stated they were the minutes of the corporation used by the corporation in its business?

A. Yes.

The Court. *All right, let them be admitted in evidence.*

Mr. Simpson. All of the minutes?

The Court. Yes.

Mr. Simpson. Even those at which witness was not present at a meeting?

The Court. All of the minutes that the witness kept.

Mr. Simpson. We don't know which they were. We would like to find out. We don't know.

The Court. Overruled." (R. 224, 5.)

The witness McLachlen further testified that the exhibits did *"not purport to relate everything that transpired at the meetings"*. (R. 231.)

Defendants' counsel moved to strike from Exhibit 16-A, the minutes of the meetings which the witness did not attend, on the very proper legal grounds that no foundation had been laid for their introduction; that they were hearsay and a violation of the constitutional right to confrontation of witnesses (R. 236), *which motion was denied.*

The exhibit contains purported minutes, beginning with those of March 10, 1928, and ending with that of December 7, 1928, and includes purported action of the Board, with reference to the transfer of the corporate assets of Italo American Petroleum Corporation to Italo Petroleum Corporation, alleged to have been one of the objects of the conspiracy. (R. 236-7.) They also deal with the application of Italo American Petroleum Corporation, for the permit to sell 300,000 shares of common and 300,000 shares preferred stock (March 14, 1928); with the borrowing of $80,000 from defendant Shingle (May 16, 1928) and with securing the Corporation Commissioner's Permit authorizing the Brownmoor transaction (May 21). (R. 238-9.)

Exhibit 58. Photostatic copies of statements from Bacon & Brayton to Wilkes and Cavanaugh, a partnership. The sole foundation for their admission in evidence is the testimony of Ada P. Lyle, called by the government, to the effect that they were copies of statements kept by Wilkes and Cavanaugh while she was with them. (R. 284.) Not a word as to whether those entered by him were correct. (R. 468-9.)

Exhibits 32-A and 32-B. Brownmoor Oil Co. books of account. Francis King was the government's foun-

dation witness as to these exhibits. He testified that he was bookkeeper for the corporation from July, 1927, to April or May, 1928 (R. 467); that 32-A and B were Record Book and Ledger; that he "made entries in these two books" while there and "they were kept in the regular course of business to reflect the financial transactions" of the corporation. Nothing to show what he knew as to correctness of books or whether all the entries were made by him or even whether those entered by him were correct. (R. 468-9.)

Exhibit 147. "Stock Journal and Ledger". These records were produced from Bank of America files by a witness (John Russel Davis) who made none of the entries and had no personal knowledge of the transactions. (R. 368.) Immediately they were admitted the District Attorney called their contents to the attention of the jury. (R. 650.)

Exhibit 239. The Minute Book. This book was also identified by Francis King, bookkeeper for the corporation, employed between the dates above mentioned. (R. 467.) By his own testimony he was not present at the meetings but posted some of the minutes which were handed him by Siens and Shores. (R. 467.) He said the minutes were kept in the regular course of business. (R. 468.)

Records of Shingle, Brown & Company and allied companies.

Exhibit 183. File of Montgomery Investment Co., a partnership consisting of Shingle, Brown, Mikel and Jones. The file was identified by L. J. Byers, accountant called by the government. (R. 448.)

Byers testified that he was in the employ of Shingle, Brown & Co. from August 1, 1928, to December 31, 1930; that he supervised the accounts, and the entries were made by him or under his supervision. (R. 447.) But he failed to state whether they were true and correct, or upon what evidence he based the entries. (Used as a basis for testimony of Goshorn.) (R. 448.)

Exhibits 184-205 are ledger cards, special accounts, etc., carried in the books of *Shingle, Brown Company;* and were all introduced through the identifying testimony of government witness Byers. He said that *he had no personal knowledge of the entries made in Exhibit 185 prior to August 1, 1928;* that Exhibits 186-188 were made under his supervision; that Exhibits 189-193 are journal books of account of Shingle, Brown & Co., *that they contain entries made prior to his employment in August 1, 1928;* that all entries since relate to Shingle, Brown & Company, a corporation; that all are used by the corporation in usual course of their business. (R. 449-451.) No identification at all was offered for the parts of the books which were written prior to August 1, 1928, and no evidence of the *correctness* of the items made since or whether the witness had any knowledge of their truth or falsity. Neither of the McKeons were stockholders or interested in any way in the business of that company.

Exhibits 206 and 207 were designated by witness as *corporate records of Shingle, Brown & Co.;* one book bearing dates June 1, 1928, to June 15, 1928 (*which was prior to witness' employment*), and the other date from December 1, 1928, to December

15, 1928. No testimony was offered as to the correctness of the contents of either exhibit. (R. 451-452.)

Exhibits 208-223. Ledger accounts of various individuals identified by witness Byers. He testified that he didn't know what account Exhibit 208 was, except that it was marked "A. F. Jones Reserve Account" (R. 452); that all of these exhibits were part of the records of Shingle, Brown & Co.; that Exhibits 212 and 214 cover period from May 30, 1928, to December 31, 1928; that all of the records identified by him were either kept by him or under his supervision *or "turned over to"* him when he went to work for the corporation. (R. 454.)

Exhibit 224. Ledger account with McKeon, Wilkes, Siens and Cavanaugh according to Byers. He testified that with the exception of one of the circumstances of which he had forgotten, *he didn't make the entries and didn't know which McKeon was referred to.* (R. 456.)

Exhibits 225 and 226—identified merely as records of Shingle, Brown & Co. (R. 457) without any evidence of their integrity.

Exhibit 227—purports to be a photostatic copy of an original document handed Byers by defendant, Shingle, which Byers testified he used to set up the accounts of "Fred Shingle, Syndicate Mgr.". (R. 457.) (The document appears on page 458 of the record.)

Exhibit *228*—the final exhibit identified by witness Byers as ledger sheets pertaining to "McKeon Escrow Account", and as having been prepared by him or

under his supervision. (R. 459.) He testified that the account reflected "generally the movement of the stock in the escrow". (R. 459.)

All of the foregoing Exhibits 183-228 inclusive, were used by witness Goshorn as basis for his testimony, and charts. (R. 1436 and 450-451.)

Records of Italo Petroleum Corporation of America.

Exhibits 28A, B, C, and D, and 29, 31 and 33. The above exhibits were identified by government witnesses Davis, Jefferson and Human. Jefferson contributed to the foundation for Exhibits 28A, B, C, and D by testifying that he had charge of the accounting records of said corporation from July 1, 1928, to the end of December, 1928. He further testified:

> "I identify a portion of these four books as records kept in the Los Angeles office while I was employed there. They are largely operating records and contain all of the transactions that passed through the Los Angeles accounting office. The entries were made under my supervision. To the best of my knowledge and belief they are an accurate history of the transactions." (R. 254-255.)

Human was then called to assist in getting the exhibits into evidence. He testified that he worked under Jefferson and during the same period Jefferson was employed; that various persons worked on the books; that he was instructed by Jefferson to build up the company's records (R. 255), and that said exhibits reflected the transactions of the corporation during his employment. On cross-examination he admitted

he did not make the entries in Exhibit 28A but that the "style" of it was made by Phillips under his direction. He stated that he had seen in the office and given information to defendant Siens, Lyons, Masoni and DeMaria concerning the records at their request, *but did not give any information concerning the records to any other defendant.*

Upon redirect and recross examination it developed that the entries in the exhibits with reference to the Brownmoor transaction were the rankest hearsay.

He testified:

> "We obtained information from Mr. Francis King who had been the Brownmoor bookkeeper as to the accounts paid and those payable by Italo to place on the books, and to show the assets and liabilities of Brownmoor. We ran down various details of transactions which we placed on our books as of May 28, 1928. * * * *I talked with various persons to get information concerning the Brownmoor deal with Italo in order to set it up on the Italo books. At that time I had no personal knowledge of the Italo-Brownmoor deal and did not personally know that the persons with whom I talked had personal knowledge of that deal.* I inquired in my conversation with these individuals as to whether they personally knew anything about the Brownmoor deal." (R. 257.)

And finally the witness, Human, very definitely disclosed the lack of foundation for the admission of these records by the following testimony:

> *"I can't say whether these books properly reflect the Brownmoor transaction or not.* It is the best information we had. We were endeavoring to as-

> certain the revenue and liabilities of Brownmoor and Italo on the transaction. These books did not exist in August 1928. We started building them and *secured information from every one to build them up by talking with other people and examining different documents.* We sent this information to San Francisco. Whether all of it was entered in the San Francisco books I could not say. We later brought together the results of our investigation in these books and what we understood was on the San Francisco books, and that is the data that now appears on these books I identified, Exhibits 28-A, B, C, D, 29 and 31. *Whether the data in these books is correct depends upon whether or not the information I received is correct.*" (R. 258-9.)

It thus appears that the books were set up as a result of information gathered from numerous individuals, that the entries were not made contemporaneously with the transactions described therein, and none of the witnesses could testify whether they were in fact correct. (R. 259.)

Davis stated that he *was employed* by defendant, Lyons, in *January, 1929,* as accountant for Italo Petroleum Corporation of America; that Exhibits 28A, B, C, and D were in the office of the company all of the time he was there; that Lyons "indirectly supervised the work of the entire bookkeeping force"; that the books were used for the purpose of recording the daily transactions and the entries were made approximately at the time the items occurred (R. 260-1); that he ceased to work for the corporation in May, 1930.

The books were offered in evidence up to May, 1930, as to all entries made therein. After an objection

which consumes three pages of the record (R. 262-4), the Court admitted the exhibits in evidence. When cross-examined the witness testified that Exhibit 28A, was the capital ledger for years *1928*-30; Exhibit 28B a book of journal vouchers for the years *1928*-9; Exhibit 28C, general ledger for years *1928*-30. (R. 265.)

All of these records were used as a basis for the testimony of government accountant Goshorn. (R. 265.)

Rule as to foundation for admission in evidence of private books and records and the constitutional right involved.

The admission of private books of account and minute books of corporations constitute an encroachment upon the hearsay rule, for the reason that the individual who makes the entries rarely has any personal knowledge of the facts upon which they are based. It might be (as was stated by the witness Baldocchi with respect to one set of records), that an officer of the corporation gives the bookkeeper a memorandum of his construction of something that has happened long before; it might be that that interpretation is shaded to favor the informant, or it might be that the informant was in error, as to the facts related to the bookkeeper. Despite these dangers, under certain circumstances hearsay testimony of this character is admissible in evidence, *only however, in subordination to legal principles highly protective in character and rigidly enforced.*

The doctrine under which such evidence is admitted, originated in civil cases and has by many courts been held not to apply to criminal cases. The Sixth Amend-

ment to the Federal Constitution guarantees the accused in a criminal action the right to be confronted with witnesses against him. Under this rule the accused, to quote from the decision in

U. S. v. Angell, 11 Fed. 34, 43 (First Circuit), is entitled to

> "enjoy the right to be confronted with the witnesses against him; *and this without exception, not if they can be produced nor if they be within the jurisdiction, but absolutely and on all occasions.*" (Italics ours.)

The admission of books and accounts, or minute books of a corporation against an individual accused of crime, unless kept by him or under his supervision, even when supported by the testimony of a witness who testifies from his or her own knowledge that the books contain true and correct statements, is a violation of this constitutional right. But if a trial court carries the matter one step further and permits books to be introduced solely upon their identification by a witness, who neither kept them nor supervised their keeping, who is not in a position to testify whether the entries were true or false, correct or incorrect, you then have hearsay pyramided upon hearsay and a most flagrant violation of the constitutional right is committed.

It would deprive the accused of his right to cross-examine the witness testifying against him, for, the identifying witness could not be cross-examined as to the items in the books or the facts stated in the minutes, because he would know nothing of them. In such case the defendant is not only *not* confronted by wit-

nesses, who could testify to the facts represented by the entries, but is *not* even confronted by the witness who made the entries in the books.

The books may contain entries designed to protect a defaulting officer. They may be colored to avoid the higher brackets of the income tax; they may contain errors; they may even be a manufactured set of books, designed for some ulterior purpose, and yet the defendant against whom they are used would be denied the opportunity of being confronted by the witness who made the entries, so that he might determine, for the benefit of himself, the court and the jury, whether or not the records are true and correct and accurately represent what they purport to show.

And if, after the introduction of such books and records without proper foundation or identification, the court permits a total stranger to them, e. g., a government accountant, to testify as to his conclusions and opinions from such books and records, there is created such a violent disregard of constitutional rights, as to clearly entitle the defendants, so imposed upon, to a reversal of the judgment.

Foundation required for admission of books of account and corporate minutes.

With singular unanimity the decisions hold that before private books of account and minutes of corporations can be admitted in evidence for any purpose they must first be identified and authenticated and it must be established by competent evidence that

(a) They were kept in the regular course of the business,

(b) The entries are original entries or the first permanent entries of the transaction,

(c) The entries were made at the time or within reasonable proximity to the time of the transactions represented,

(d) The persons making the entries must have had personal knowledge of the facts involved or have obtained such knowledge from a report regularly made to them by some other employee whose duty it was to make such a report in the regular course of business, and

(e) That the books were correctly kept.

The rule upon which appellants rely has been repeatedly enunciated by federal and state appellate tribunals.

In the leading case of

Chaffee v. U. S., 18 Wall. 516, 21 L. Ed. 908, 912,

the court said:

"And that rule, with some exceptions, not including the present case, requires, for the admissibility of the entries, not merely that they shall be contemporaneous with the facts to which they relate, *but shall be made by parties having personal knowledge of the facts, and be corroborated by their testimony, if living and accessible, or by proof of their handwriting, if dead or insane, or beyond the reach of the process or commission of the court.* The testimony of living witnesses, personally cognizant of the facts of which they speak, given under the sanction of an oath in open court, where they may be subjected to cross-examination, affords the greatest secu-

> rity for truth. Their declarations, verbal or written, must, however, sometimes be admitted when they themselves cannot be called, in order to prevent a failure of justice. The admissibility of the declaration is in such cases limited by the necessity upon which it is founded." (Italics ours.)

In the case of *Chan Kiu Sing v. Gordon,* 171 Cal. 28, 31, the Supreme Court of California reversed the judgment of the lower court upon the ground that the account books were improperly admitted in evidence, because the only evidence of their authenticity was that they were kept under the direction of the witness, and he was familiar with them, the court saying:

> "In order to lay the foundation for the admission of such evidence it must be shown that the books in question are books of account kept in regular course of the business, that the business is of a character in which it is proper or customary to keep such books, *that the entries were either original entries or the first permanent entries of the transactions,* that they were made at the time, or within reasonable proximity to the time, of the respective transactions, *and that the persons making them had personal knowledge of the transactions, or obtained such knowledge from a report regularly made to him by some other person employed in the business whose duty it was to make the same in the regular course of the business."* (Italics ours.)

The two decisions above referred to were quoted with approval by this court in

Osborne v. U. S., 17 Fed. (2d) 246.

In

Pabst Brewing Co. v. Horst, 229 Fed. 913, 919 (9th Circuit),

this court held account books inadmissible, because there was

> "not the slightest testimony as to how the books were kept, by whom they were kept, when the entries were made or the source from which they were made."

In the case of

Singer v. U. S., 58 Fed. (2d) 74, 76 (3d Circuit),

in reversing a judgment of conviction because of the improper admission in evidence of books and records the court said:

> "Original entries of transactions made in the regular course of business WHEN THE ENTRANT IS DEAD OR OTHERWISE UNAVAILABLE upon being identified are admissible. Such entries are also admissible when *the entrant is present, identifies them and testifies that they are true,* though they do not refresh his memory and he has no independent recollection of the truth of the transactions which they record. This rule grew up as a matter of convenience, but, under the exigencies and complexities of modern business, it has become a rule of necessity without which the administration of justice in many matters would be difficult or impossible. The 'J. S. Warden' (C. C. A.), 219 F. 517, 521, and the many cases there cited. It is clear that these memoranda do not come within the above rule, and it was error to admit them in evidence. Government Exhibit 94 likewise was inadmissible because it was not shown that the entries were made in the regular

course of business, NOR WHO THE ENTRANT WAS, NOR WHETHER OR NOT HE WAS AVAILABLE FOR TESTIMONY." (Italics ours.)

A leading case upon this subject is

Phillips v. U. S., 201 Fed. 259, 269 (8th Circuit).

After quoting from several decisions, the court said:

"As stated by the Supreme Court, all of the approved treatises on evidence lay down the rule as stated in these decisions. If this rule obtains in civil cases, *it should not be relaxed in criminal cases.* It results, therefore, that the books of the Hanover National Bank were improperly admitted in evidence, *in the absence of the testimony of some person who either had some knowledge of the correctness of the entries made, or some knowledge of the original transaction upon which the entries were founded, and in the absence of testimony showing that the person or persons who possessed such knowledge were either dead, insane, or beyond the jurisdiction of the court.*"

In this case it is also held error for the trial court to permit an accountant to testify to a summary in these books and documents in the absence of testimony which would allow the books themselves to be admitted.

The authority just cited was followed and approved in

Beck v. U. S., 33 Fed. (2d) 107, 113 (8th Circuit),

where, among other things, it is said:

"These books, however, were not identified in accordance with the rule laid down by this court

in Phillips v. U. S., 201 Fed. 259, where the records of a national bank, identified by its city manager, were excluded."

Without quoting from the decisions, we invite the court's attention to:

Hagan Coal Mines v. New State Coal Co., 30 Fed. (2d) 92, 93 (8th Circuit);

Reineke v. U. S., 278 Fed. 724 (8th Circuit);

Worden v. U. S., 204 Fed. 1, 6 (6th Circuit);

People v. Blackman, 127 Cal. 248;

Southern Ry. Co. v. Mooresville Cotton Co., 187 Fed. 72, 74 (4th Circuit).

The rule is a salutary one.

We shall close this phase of our argument by a very appropriate quotation from the concurring opinion of the late Justice of the Supreme Court Sanborn, written while on Circuit Court duty in the case of

Thomas v. U. S., 156 Fed. 897 at 914.

After commenting upon the danger of violating the "hearsay" and "confrontation" rule by the admission of books of account without proper authentication thereof, Justice Sanborn said:

> "No rule of law is more salutary or more indispensable to the security of the life, liberty and property of the citizen than that which prohibits the repetition of the written or oral statements of absent persons to determine issues between litigants and commands that, only after due notice, after opportunity for cross-examination of the very parties whose statements are offered and then only under the solemnity of an oath or affirmation, shall their stories be evidence."

IV.

THE TRIAL COURT ERRED IN ADMITTING IN EVIDENCE OVER THE OBJECTIONS OF DEFENDANTS McKEON, PURPORTED RECORDS OF CORPORATIONS AND PARTNERSHIPS UPON THE GROUND THAT THERE WAS NO SHOWING THAT THEY HAD ANY KNOWLEDGE OF THE BOOKS OR EVER HAD CUSTODY OR CONTROL OF THEM.

The books and records referred to are those described in the preceding section of this brief (Point 3), supplemented, however, by the books and records hereafter referred to. The assignments of error covering the errors committed by the trial court in admitting these books and records in evidence follow the title to said point. The additional books and records are as follows:

Books of account and minute book of John McKeon, Inc. (Assignment of Error No. 39.) (R. 1438; Exhibits 245-A, B and C.)

Objection and ruling. (R. 480.)

Motion to strike all of the above exhibits herein referred to and ruling thereon. (R. 686-8, 689.) (Assignment of Error No. 55.)

Books of account of McKeon Drilling Co., Inc. (Assignment of Error No. 32.) (R. 1429-30.) (Exhibits 86-A, B, C and D.)

Objection and ruling. (R. 308, 309.)

There was a total lack of evidence that either John McKeon or Robert McKeon had any connection whatsoever, either as a director or stockholder of any of the corporations above referred to, or was interested

in any of the partnerships, save and except that Robert McKeon was a director of the Italo Petroleum Corporation and both McKeons were interested in John McKeon, Inc. and McKeon Drilling Company. There was no showing that either John or Robert McKeon had anything whatever to do with the keeping of the minutes of any corporation above referred to, or that either of them made or directed to be made any entries in any of the books or records introduced in evidence, or had any knowledge of the contents of the books of any of said corporations or partnerships.

The books of the Italo-American Petroleum Corporation were offered for the purpose of establishing the allegation of the indictment that that corporation declared an alleged illegal dividend. The dividend was purported to have been declared in 1925 and there is nothing in the record, that even suggests or insinuates that either of the McKeons had anything to do with that corporation AT ANY TIME, or with any of the officers of that corporation, during the period in which the dividend was declared or paid. On the contrary it was without contradiction affirmatively shown that neither John nor Robert McKeon had any connection at any time, either direct or remote, with such corporation. (R. 1118, 1203.)

This absence of any showing, that the defendants McKeon or either of them participated in the preparation of the records of any of said corporations or partnerships, or that they were directors or officers or stockholders or members thereof (excepting of course, the records of the McKeon Companies and

the directorship of Robert McKeon in the Italo Petroleum Corporation), was fatal to their introduction in evidence as against either of them.

While, during the last century, the courts have gradually built up an exception to the hearsay rule, in favor of admitting in evidence under certain and definite restrictions, books of account and corporate records which have been first authenticated, as true and correct, the same courts have been adamant in holding, that even though the books and records have been properly and adequately authenticated, they are never admissible against strangers to the record, even in civil cases, not alone in criminal cases where the constitution protects the accused against such evidence.

The rule is that books of account and corporate records are admissible against an accused, only where it is shown that he kept the books or records in question, or had such close personal supervision of the making of the entries therein, that he must be presumed to have actual knowledge of their contents. To quote authorities to the court upon such a reasonable and elementary principle would be like "carrying coals to Newcastle", so we will content ourselves with citing a few cases in which the rule invoked has been enunciated.

The principal case in California, based almost entirely on decisions of the federal courts of appeal is that of

People v. Doble, 203 Cal. 510,

which involved a conspiracy to violate the Corporation Securities Act of California. The appellant was the president of the corporation

> "but was actively engaged only in another department of the business and had but little to do with the stock sales department." (p. 513.)

The prosecution examined an expert accountant, whose summary and testimony were based upon the books of the corporation, as well as those of F. G. Cox, its financial agent, who had been authorized by the corporation to take subscriptions for the sale of its stock and to make reports and remittances to it at certain stated times. The summary was admitted in evidence over the objection of the appellant that

> "the books from which it was made had not been properly authenticated, nor had they been received, nor were they admissible in evidence." (p. 514.)

In holding that even the books of the corporation were not admissible against appellant, the court said:

> "Further, it will be seen that a more serious error was committed when it is recalled that appellant was in nowise connected with the said entries, it being expressly admitted that he had no knowledge whatsoever of the books and had no custody or control whatsoever over them. The entries were not made by Cox and were therefore at most the acts of subagents and ordinarily would not be binding even in a civil action on appellant." (p. 515.)

Speaking with reference to the books of the defendant Cox, the entries in which were admitted to have been made by him and their inadmissibility against Doble, the court further said:

> "It is contended, however, that said books and the summary thereof were admissible as the acts

> of an agent as to the substantive offenses charged and as the acts of a co-conspirator as to the offense of conspiracy. If we admit that Cox was the agent of appellant, this might allow his declarations, made within the scope of his agency, to be admitted in a civil cause, but human liberty does not rest upon so weak a foundation. A principal, in order to be held criminally liable, must be shown to have knowingly and intentionally aided, advised, or encouraged the criminal act committed by the agent. In the absence of proof to this extent, the summary of the books should not have been received as a declaration binding upon appellant and certainly, if other evidence was deemed sufficient to warrant a finding that appellant knew of the contents of the books, the smallest consideration of the rights of appellant, in view of his denial of such knowledge, would have required the court to have given in fact or in substance appellant's requested instruction No. 62, which it refused to do." (p. 515.)

And after citing cases to the point in a criminal case

> "the civil doctrine that a principal is bound by the acts of his agent within the scope of the agent's authority has no application"

and dealing with the books of the corporation of which Doble was the president, the court further said:

> "It should also be observed that said summary received in evidence was compiled not only from the Cox books, *but also from the books of the Doble corporation* and from a comparison of the two sets of books. But again appellant denied all knowledge of the entries in the books of said corporation, in so far as the same were summarized and received in evidence. The summary of the

> Doble corporation books was apparently admitted upon the theory that the set of books from which the entries were taken consisted of books required by law to be kept and hence admissible for that reason. While the books were admissible for what they might show as to the excess of subscriptions over the permits, still, *in view of the repeated claims of appellant that he knew nothing of their contents,* he was entitled to an instruction to the effect that an officer of a corporation is not criminally liable for the acts of other officers or agents thereof unless he directly authorized or consented to such acts." (Italics ours.) (p. 517.)

And after quoting from and approving the case of *Worden v. United States,* 204 Fed. 1, to which reference will hereafter be made, the court concludes:

> "It will thus be seen that in the trial of an offense highly technical in its nature serious prejudicial errors occurred affecting the substantial rights of appellant. Without the summary above referred to the whole fabric of the case for the People would have been weak and unconvincing."

The position of the appellants in this case, should appeal more strongly to the court, than that occupied by Doble. In the instant case it was never contended, that either appellant ever had any connection with any of the corporations or copartnerships, excepting the McKeon Drilling Company and McKeon Company, and as to the defendant Robert McKeon, the Italo Petroleum Company, and the latter had no participation in or knowledge of the proceedings of the board of directors of the Italo until after it approved the purchase of the McKeon Drilling Company's prop-

erties. It was neither claimed nor shown, that any of the defendants on trial was familiar with the entries in any of the books of these concerns or personally directed the making thereof, and yet as against appellants, all of these books and records were admitted in evidence and upon them was built the summaries prepared by Goshorn. How it can be considered that such books were properly admitted is to us incomprehensible.

In *Worden v. U. S.,* 204 Fed. 1, 9, Worden and others were jointly indicted on a charge of conspiracy to defraud the United States in the purchase of certain public lands through alleged "dummy" entrymen, for the benefit of plaintiffs in error, and the J. H. Worden Lumber etc. Company, of which said Worden *was president and manager.* The books of account, both of Worden and of the company, over the objection of the defendants, were admitted in evidence. In reversing the judgment of conviction of the lower court, the court said:

> "It is manifest that Worden would be prejudiced by an improper treatment of the entries on the company's books as competent evidence against him. Unless the mere fact of Worden's presidency and management of the company, raised a legal presumption of his acquaintance with the book entries, thus putting upon him, in defense of a charge of crime, the burden of rebutting such legal presumption, we think the books cannot, in the peculiar state of this record, be held as matter of law competent evidence against him. We have found no persuasive decision sustaining such legal presumption (in the absence of statutory requirement of correct book-

> keeping), except on proof that the books were kept under the instruction, direction or supervision of the person against whom the entries are offered, or that such person presumably had examined the books or in some way obtained actual knowledge of the entries."

In the case of *McDonald v. U. S.,* 241 Fed. 793, 800, one Hendrey, the president of a Memphis bank, with plaintiffs in error and six others, was indicted for using the mails in furtherance of a scheme to defraud by organizing a company, called a bank, but in substance a holding company or chain of banks, and selling stock in and getting deposits therefor by false representations. In reversing the judgment of conviction, the court held:

> "Evidence was received as to the contents of the books of the Memphis bank of which Hendrey was president. This bank was a corporation, and the contents of the books of the corporation could not be put in evidence in a criminal prosecution against the president, without a more direct showing of his personal responsibility for the bookkeeping than we observe here. Worden v. United States (C. C. A. 6), 204 Fed. 1, 9, 122 C. C. A. 315."

See also:

People v. Blackman, 127 Cal. 248, 253;
Osborne v. U. S., 17 Fed. (2d) 246, 248.

As the defendants futilely endeavored to protect themselves against the errors just discussed by submitting a proposed instruction with that end in view, we will next take up the error of the trial court in refusing to give the instruction.

V.

THE COURT ERRED IN REFUSING TO GIVE INSTRUCTION NO. 55 REQUESTED BY ALL DEFENDANTS (ASSIGNMENT OF ERROR NO. 93, R. 1525), AND IN GIVING THE INSTRUCTION WHICH APPEARS ON PAGE 1292 OF THE RECORD AND IS DESCRIBED IN ASSIGNMENT OF ERROR NO. 394. (R. 1526.)

The two errors mentioned above are here considered together, for the reason that the instruction given and the instruction refused, relate to the same principle of law, the former being an incorrect statement of the principle and the latter the true expression thereof. Necessarily, the same authorities which sustain the one, repudiate the other.

Not only does the evidence disclose, as we have demonstrated hereinabove, that the defendants McKeon had no connection with the various corporations whose books were admitted in evidence, with the exception of the McKeon Drilling Company, and with the exception of Robert McKeon's directorship in "Italo", but (as the given instruction above referred to states) they "testified that they did not know the contents" of the books in question.

Under the authorities just cited (supra, pages 277-282) none of these books were admissible against either of the McKeons because it was not proved that they made the entries therein, or knew their contents.

In an effort to save themselves from the prejudicial effect, of the erroneous admission in evidence of the books in question, the defendants requested the giving of a corrective instruction, as follows:

> "You are instructed that all of the evidence which has been received in this case is not applicable to all of the defendants. Only such evi-

dence as tends to directly connect a particular defendant with the offenses charged in the indictment, can be considered by you in determining the guilt of that defendant. With respect to the books of account and other records of the various corporations concerning which testimony has been admitted, you are instructed that the mere fact that a defendant is an officer, director, or employee of such company, does not make such books in anywise admissible as to him. Before any entry in such books can be considered by you in determining the guilt of any defendant, it must first be proven to you beyond a reasonable doubt that such defendant made, or caused to be made, that particular entry, or that it was made with his knowledge and under his supervision. Unless you so find, no entry in the books of account can be considered by you in any manner as proving or tending to prove the guilt of any defendant. (Osborne v. U. S. (17 F. (2) 246), C. C. A. 9.)" (R. 1319.)

The trial court spurned the opportunity of correcting its serious error and, flying directly in the face of the unanimous and unquestioned authority of the decisions hereinbefore cited, gave the following instruction, which instead of relieving the error, magnified it:

"Some of the defendants have testified that they did not know the contents of the books and records of any of the corporations involved in this prosecution, and in this connection you are instructed that if you find from the evidence that such defendants dominated and controlled and had access to the books and records of such concern or concerns, and that such books and records

were kept under their direction, you may infer that they had knowledge of the contents thereof for everyone who is in control of an organization and has the right of access to its books and records and under whose direction such books and records are kept is charged with knowledge of their contents." (R. 1292.)

When one for the moment considers that the Government, in putting in its case, placed such great reliance upon the importance of the inferences, to be drawn from those books so erroneously admitted, as to place those inferences on charts of such startling dimensions as surely must have established some kind of a world's record for size of exhibits in a court of justice, it is difficult indeed to believe that the error in the refusal of the one instruction, and the giving of the other was a trivial thing.

For authorities upon the proposition that such errors entitled the appellants to a reversal of the judgment see pages 277-282 herein.

VI.

THE COURT ERRED IN ADMITTING IN EVIDENCE OVER DEFENDANTS' OBJECTIONS, THE SUMMARIES PREPARED BY THE WITNESS GOSHORN (U. S. EXHIBITS 297 AND 299), IN OVERRULING DEFENDANTS' OBJECTIONS TO THE EVIDENCE OF SAID WITNESS DIRECTED TO SAID SUMMARIES AND THEIR ITEMS AND GIVING THE RESULT OF THE INVESTIGATIONS MADE BY HIM, AND REFUSING TO STRIKE SAID EXHIBITS FROM THE RECORD. (Assignment of Error 47, R. 1447-8; Assignment of Error 47-A, R. 1448-60; Assignment of Error 48, R. 1461-2; Assignment of Error 51, R. 1471-3; and Assignment of Error 53, R. 1475.)

The matters involved in each of the assignments of error above referred to relate to the same subject-matter and involve a discussion of identical legal principles and therefore, for the sake of brevity and the convenience of the court, we are giving them collective consideration.

Towards the conclusion of the government's case, over the objection of defendants, two exhibits were introduced in evidence (U. S. Exhibits 297 and 299) which had been prepared by the government's accountant, G. S. Goshorn, each of which exhibits contained two summaries.

The first summary appearing in Exhibit 297 characterizes and purports to show the disposition of the 4,500,000 shares of stock issued and delivered to the McKeon Drilling Company (R. 595-7) and the other the alleged realization by certain of the defendants from such purported disposition. (R. 598.)

The first summary appearing in Exhibit 299 purports to represent the disposition of the 600,000 units of Italo stock paid for the assets of the Brownmoor Oil Company (R. 636-7), while the second summary

purports to show the alleged realization by certain defendants from such purported disposition. (R. 638-9.)

A chart approximately five feet wide and ten feet high representing each of these exhibits was placed on a standard and thereafter and throughout the trial maintained in the jury room in full view of the jury. (R. 594; 635.) Likewise, over the objection of the defendants, to which reference will be made in another point and under another title, these summaries were taken into the jury room and considered by the jury during its deliberations. (R. 1135; 1140-1.)

The first of these summaries (Exhibit 297) arbitrarily divides the 4,500,000 shares of Italo stock issued and delivered to McKeon Drilling Company for its assets into two classifications, viz.,

(a) That which is characterized on the summary as stock retained by McKeon Drilling Company purporting to represent the actual consideration received by it for its assets and therein stated to be 2,015,711½ of common stock, and

(b) Stock characterized in said summary as "bonus" or "commission" stock, therein stated to have been distributed by McKeon Drilling Company, amounting to 1,484,288½ of common and 1,000,000 shares of preferred stock. (R. 595-7.)

The second summary (Exhibit 297) purports to represent the amount realized in cash and stock from the distribution of the 4,500,000 shares of stock received by the McKeon Company. (R. 598.) This sum-

mary was necessarily based upon the first summary and assumed its accuracy, as well as the integrity of the characterization given thereon to the stock both common and preferred. Any defect in the first summary destroyed the accuracy of the second.

After the first summary had been exhibited to the jury, upon the objection of the defendants the word *"bonus",* wherever it appeared therein, was directed to be stricken out, and over the objection of defendants, the word "commissions" ordered to be substituted therefor. (R. 601-3.) This change, however, was never made and the word "bonus" remained, as it still appears, upon the summary. (R. 595-7, Items 16 and 39.)

An identical situation exists with respect to the first summary appearing on Exhibit 299. While during the examination of the witness with reference to this summary, the court stated:

> "Well, we will eliminate the word 'bonus' for the present as being more or less a conclusion of the witness. It is something that a jury will pass upon" (R. 641),

the word *"bonus"* was permitted to remain and still appears upon the summary. (R. 636.)

To the introduction in evidence of these summaries as well as evidence given upon direct examination by Goshorn respecting the matters shown thereon, which evidence was in effect a literal repetition of what appeared in the summaries, the defendants objected, which objection was overruled by the court. (R. 590-592; 599; 600-3; 606-7; 617-8; 635.)

It was agreed that the objections made should stand as to all questions asked of the witness respecting the matters appearing on the summaries. (R. 600.)

Upon the conclusion of Goshorn's testimony the defendants moved to strike out Exhibits 297 and 299 upon the ground that the testimony of the witness showed that said exhibits were incompetent; that they were made up in part from records that were not in evidence and in part by statements made by individuals which were hearsay, which motion was denied. (R. 680.)

Claim of defendants.

Briefly epitomized, it is claimed by defendants that each of these summaries, together with oral testimony given by the witness in support thereof and relating thereto, was inadmissible principally upon the following grounds:

(a) That the evidence was nothing more or less than the opinion and conclusion of the witness with respect to disputed matters of fact upon issues vital to the defendants, the determination of which disputed matters from the evidence was exclusively within the province of the jury, and that by the admission of this evidence the court permitted the opinion and conclusion of the witness to be substituted for the judgment of the jury,

(b) That the summaries in evidence were based in large measure upon books and records not offered or introduced in evidence and not before the court or jury,

(c) That Exhibit 297 and the evidence of Goshorn relating thereto, was based upon the assumed truth and effect of the oral testimony of George Stratton.

(d) That no proper foundation was laid for the introduction of the books upon which the summaries were in part based, and

(e) That the summaries were inadmissible against the McKeons because their introduction was in violation of the Bill of Particulars.

Points (d) and (e) will not be discussed here for the reason that the legal principles therein involved are given consideration elsewhere in this brief. It might be well, however, for us to supplement the authorities elsewhere herein cited in support of Point (d) by a particular reference to the case of

Phillips v. United States, 201 Fed. 259 at 260, where the Circuit Court of Appeals for the Eighth Circuit reversed the conviction of the defendant because of the error in admitting the testimony of an accountant with reference to books erroneously admitted. The following language appears in the decision:

> "We think, however, that the true rule is that before such expert testimony may be given the books or documents must be public records, or, if they are private books of account or documents, that sufficient evidence must first be given to admit the books or documents themselves in evidence, unless the books or documents are admitted to be correct. Otherwise, items in books of account might be given in evidence through the testimony of an expert accountant, when the

account books themselves would not be admissible. This would seem to be wrong in principle and dangerous in practice."

(a) The summaries Exhibits 297 and 299 were conclusions of witness as to disputed facts.

That the exhibits themselves, as well as the evidence of the witness relating thereto, constituted nothing more or less than the witness' conclusion and opinion based upon his understanding of the evidence, oral and documentary, introduced upon the trial, as well as upon certain books and records not in evidence, is not only apparent from an examination of the documents, but was admitted by the witness and demonstrated upon his cross-examination, to which reference will shortly be made. That considering the issues to be determined by the jury, this evidence, both oral and documentary, was highly prejudicial and in all probability the turning point in the case with respect to the jury, cannot be successfully challenged.

In presenting this point, excepting as to the law, we will discuss the two exhibits and the evidence relating thereto separately.

Exhibit 297 reflected solely the opinion and conclusion of the witness.

It was the claim of the government and one upon which it principally relied in support of the indictment, that 1,484,288½ shares of common and 1,000,000 shares of preferred stock of Italo, out of the 4,500,000 shares transferred to the McKeon Company in exchange for its assets, was "bonus" or "commission" stock, which stock or its avails formed no part of the

real consideration for such assets, but by prearrangement between the parties was to be ultimately acquired by the officers and those alleged to be in control of the Italo Petroleum Corporation.

The integrity of this claim was vigorously assailed by the defendants who contended and testified that no such understanding existed and that regardless of what was done with this stock by the McKeon Company it was all received by it as the actual and agreed consideration for its assets. The issue raised by these conflicting claims constituted the most important, if not the controlling issue of fact in the case.

Notwithstanding this conceded situation, by means of the graphic summaries (Exhibit 297) constantly within the observation of the jury not only during the lengthy trial but also while deliberating upon its verdict, the government was permitted to impress upon the jury the *opinion* and *conclusion* of the witness Goshorn reflected by these summaries, as well as by his evidence, that the major portion of the stock represented "bonus" stock, and that certain of the defendants received *for their own benefit* the alleged "bonus" stock or its proceeds represented by the summaries to have been distributed to or received by them. Apart from characterizing part of this stock as "bonus" or "commission" stock, and aside from asserting that the so-called "bonus" or "commission" stock was distributed by the McKeon Company (R. 595-7, Items 16 and 39) this summary detailed the names of defendants and others claimed by the witness to have received certain of said stock, the num-

ber of shares so received and the purpose for which said stock was distributed to them. The second summary undertook to state the cash and stock or either that the defendants had realized therefrom.

Without reference to the cross-examination of Goshorn, to which we will hereafter briefly refer, an examination of Exhibit 297 will quickly convince the court that the contention of defendants is firmly grounded. Item 1 represents that the 2,000,000 shares of common stock were *"retained"* by McKeon Drilling Company, Inc., the assumption being that it was the only stock consideration received by McKeon Drilling Company. Item 2 shows that 15,711½ shares were reacquired from such company, making a total of 2,015,711½ shares. Items 3 to 11 inclusive undertake to show the distribution of this stock, while Items 12 to 14 purport to show the details of Item 11. Part of this latter item, however, is characterized as *"bonus"* stock. Item 16 defines the balance of the common stock aggregating 1,484,288½ as *"bonus"* common stock distributed by McKeon Drilling Company. (R. 595-6.) In Items 16 to 36 the summary purports to show how this so-called *"bonus"* stock was distributed and in some instances characterizes the purpose of such distribution. (R. 596.) The summary relating to the distribution of the preferred stock is initiated with Item 39 which described the stock as "*'bonus'* preferred stock distributed by the McKeon Drilling Company, 1,000,000 shares". An identical situation exists with respect to the items relating to the distribution of the preferred stock. (R. 597, Items 39 to 54.)

That the word "bonus" was purposely used on the summaries and in the testimony of the witness, for the purpose of persuading the jury to believe that all of the stock so characterized was received by the McKeon Drilling Company under the alleged secret arrangement to return it to those in charge of or dominating Italo Corporation, and that it constituted no part of the actual consideration demanded or received by the McKeon Drilling Company for its assets, admits of no doubt. That it effected such intended purpose cannot be successfully challenged.

The second summary relating to the "realization" from the disposition of said stock undertakes to represent to the jury the exact amount of cash and stock, or both, received by McKeon Drilling Company and each of the defendants on trial. (R. 598.) Detailed attention will be given some of these items in directing the court's attention to Goshorn's cross-examination with respect thereto.

Direct examination of Goshorn.

An illustration of Goshorn's examination by the government to which objection was made is disclosed by the following portion of the record:

> "Q. Now, Mr. Goshorn, using the summary for the purpose of illustration, will you state what the disposition of the 4,500,000 shares of the capital stock of the Italo Petroleum Corporation of America that was provided to be paid by the McKeon Drilling Company in the contract was?
>
> Mr. Divet. That is objected to as calling for a conclusion of the witness on the construction of the exhibit and upon all the grounds urged in

the last objection. May it now be understood that the objection may stand to all similar questions concerning the exhibit.

The Court. Yes. Answer the question.

Mr. Divet. Exception.

A. The summary shows the disposition of the 3,500,000 shares of common stock, and the 1,000,000 shares of preferred stock of the Italo Petroleum Corporation of America as shown by the books and records which were issued in acquiring the properties of the McKeon Drilling Company, Inc. The first summary relates to the common stock. Line No. 1 is retained by the McKeon Drilling Company, Inc., 2,000,000 shares of common. Line No. 2 refers to reacquired common stock which was reacquired from the McKeon Drilling Company escrow with Shingle, Brown & Company, 15,711½ shares, making a total of 2,015,711½ shares, which was distributed as follows: Line 4 shows 25,000 shares of common going to a Mr. Stewart for commission." (R. 600.)

And after testifying that the word *"bonus"* stock was *his own designation* (R. 601), the witness continued to testify along the lines above indicated, his answers being confined practically to an exact repetition of what appears upon the summary. (R. 603.) Comparable testimony was given by the witness in referring to the so-called "bonus" stock items, his answers being confined to a reproduction of what appeared upon the summary. (R. 603-6.) An identical procedure was pursued with respect to the second summary. (R. 607-8.)

Integrity of objections demonstrated upon cross-examination.

If, after considering the summaries, as well as the direct examination of Goshorn, the court is in doubt respecting the admissibility of the summaries or of the witness' evidence, such doubt will be dispelled by the testimony given by the witness upon cross-examination.

Designation given to stock conceded to be Goshorn's conclusion.

With respect to this subject-matter the witness on cross-examination testified:

> "The designation given to various *matters* contained on Exhibits 297 and 299 is my *conclusion.* The use of the word *'bonus'* on Exhibit 297 is my expression." (R. 646.)

The witness then testified that the word *"bonus"* was used in the books of the McKeon Company in but one instance, with respect to 25,000 shares of stock that were given to Hugh Stewart, but it was admitted that the stock was given to Stewart *as compensation for services actually rendered* to the McKeon Company and that it had no sinister aspect, his testimony being:

> "The record shows that the 25,000 shares of common stock was given to Hugh Stewart for services to the McKeon Drilling Company. The record states that Hugh Stewart received 25,000 shares of that stock *in compensation for services rendered.*" (R. 646.)

In fact, the position of this stock in the summary shows that it was McKeon Company stock. (Ex. 297,

Item 4, R. 595.) That the word *"bonus"* is not otherwise used in any exhibit in evidence is also shown by the witness, his testimony being:

> "I don't recall any other place in the books and records that I examined and that are in evidence where the word 'bonus' appears as is shown on Exhibit 297 and 298." (R. 646.)

A similar situation exists with respect to the use of the word *"commissions"*, the witness testifying:

> "With respect to the suggestion of the district attorney that the word *'bonus'* appearing on Exhibit 297 should be substituted by the word *'commission'* I believe that the reference to the word *'commissions'* appears only on the books and records of the McKeon Drilling Company with respect to 2,000,000 shares of stock. I don't believe that the receipts in evidence for stock obtained by various individuals from Shingle, Brown & Company of the McKeon Drilling Company escrow stock the word *'commission'* appears. I believe I said that the Shingle, Brown receipts designated that stock as 'commissions'. *If I did I am in error. I did not find in the records of Shingle, Brown & Company escrow of the McKeon Drilling Company stock, any reference to any stock being paid as a commission."* (R. 646-7.)

And as showing that the use of the word *"commissions"* was entirely unjustified, the witness further testified:

> "Technically I imagine you would not call all of the 2,500,000 shares of stock as commission." (R. 624.)

And that the stock could not be regarded in the category of a "commission" with respect to some of the transactions shown upon the summary, was also conceded by the witness.

With respect to Item 17 (U. S. Ex. 297) captioned "Escrow stock substituted for syndicate stock, 35,-114¼ shares" (referring to the big syndicate), for stock inadvertently sold to Vincent & Company, he stated:

> "I would not call that a commission." (R. 624.)

With respect to Items 19, 20 and 21 (U. S. Ex. 297, R. 596) involving 473,971 shares of stock, he testified:

> "These shares were delivered to Shingle, Brown & Company from the escrow upon the order of McKeon Drilling Company, and the consideration for that direction from the escrow is not indicated.
>
> Q. So that is not properly designated as commissions?
>
> A. I will say that you can term it whatever you want to, commissions or not. *Technically, probably not.*" (R. 625.)

With respect to the item under caption, "Realization, E. Byron Siens, $238,277.45" (R. 598), the witness testified that $75,000 of that sum was represented by the proceeds from the sale of 150,000 shares of Italo common stock which came out of 200,000 shares of common stock that was posted as collateral on a note given by Siens to the Farmers & Merchants National Bank of Los Angeles evidenced by U. S. Exhibit 256. (R. 622.) This exhibit discloses that as collateral security for the note of Siens, John McKeon

delivered to the bank his *personal* note secured by 200,000 shares of Italo stock, being the stock in question, the witness upon this subject testifying:

> "That stock was attached to the note of John McKeon which was in turn collateral for Mr. Siens' note. The records of the Farmers & Merchants Bank show that the stock was collateral to the $50,000 note of John McKeon, and then that note and collateral was used by Mr. Siens as additional collateral to his note." (R. 623.)

That this loan was for the benefit of John McKeon is conclusively and without contradiction shown by his evidence. (R. 1229.)

That no part of the proceeds of this stock should have been characterized as "commissions" is conceded by the witness whose testimony is:

> "The same is true as to the stock put up with the bank to which reference has been made, which was to secure some loans by Mr. Siens and Mr. John McKeon, being 200,000 shares of common. *Apparently that was not in the way of commissions or bonuses.*" (R. 625.)

And as further showing that the "realizations" in cash and stock were nothing more than his conclusions, he testified:

> "By examining all of these books in the manner described I *concluded* that Mr. Wilkes received the amount of cash mentioned and the amount of common and preferred stock mentioned on Exhibit 297." (R. 629-30.)

Alleged ownership of stock entirely unjustified.

Throughout the summaries prepared by this witness, stock and the avails of stock are shown to have been received by named defendants. The summaries, having been introduced in evidence, the jury would have been justified in concluding, *regardless of any other evidence,* that the stock and moneys were in fact received by such defendants. Having the summaries constantly before them, particularly during their deliberations, considering the numerous exhibits, the length of the trial and the complexity of the issues, the jury could not help but be impressed and possibly could only recall what was shown upon these summaries. That these definite and positive representations were in the main unwarranted and constituted solely his opinion and conclusion was conclusively shown by the witness when cross-examined with respect to specific transactions, to some of which reference will shortly be made. Illustrating generally the basis for the representations appearing upon the summaries as to stock ownership, he testified:

> "I have not traced the stock on Exhibit 297 to its ultimate goal, but I stopped after I traced it into the hands of the persons I have shown. (R. 615.) * * *
>
> In most instances I did not go further than the first names of those persons into which the stock was first transferred." (R. 625.)

It is obvious that he did not follow this procedure in connection with the stock issued to the McKeon Drilling Company, because, as shown in the statement of facts, the 4,500,000 shares of stock were issued by

the company to Myers, as trustee (R. 609) and later, when it became desirable to escrow the stock, the entire issue, with the exception of 60,500 units sold for the McKeon Drilling Company by International Securities Company, were transferred to McKeon Drilling Company, in the name of which the certificates were issued. (R. 601, 628-9.) If, in this instance the witness had confined his testimony to the name of the first person to whom the stock had been issued, as reflected by the certificates of stock issued in the name of the McKeon Drilling Company, the books of Italo, the agreement under which the McKeon Company's assets were sold, and the escrow agreement, he would have been obliged to testify that all of the stock was received by the McKeon Company as consideration for the transfer of its assets.

If any other course were to be pursued, before undertaking to testify to the ownership of stock—assuming such testimony admissible—it would have been his duty to have made an adequate investigation, tracing the stock to its "ultimate goal" and thus to have qualified himself to testify to such ownership.

Opinion evidence demonstrated by cross-examination.

Items 36 and 48 (U. S. Ex. 297): It was claimed by the Government that some of the so-called "bonus" stock issued to McKeon Drilling Company was used to reimburse Vincent & Company for *market losses.* This claim was denied by the defendants. The truth of the transaction was necessarily of great importance to each of the contending parties. If believed by the jury, it could readily have affected its verdict.

Pressed upon cross-examination, he stated that these items were based upon U. S. Exhibit 52. (R. 615-6.) Upon being handed such exhibit, the witness then testified:

> "Exhibit 52 establishes the Bank of Italy escrow 125,000 shares of common and 125,000 shares of preferred, together with other stock placed in escrow with Bank of Italy by Shingle, Brown & Company, and Frederick Vincent signed the escrow. Exhibit 52 *does not state* that the 125,000 units were delivered to the Bank of Italy to take care of market losses of Frederick Vincent & Company. That information was obtained from the testimony of Mr. Stratton. Exhibit 52 does not state what the 125,000 units was to be used for. It states that out of the certificates of stock handed to the Bank of Italy, it is authorized 'to cause to be transferred and issued to said subscribers named in said list, or to the persons by them nominated in writing, the shares of stock of said Italo Petroleum Corporation of America to which said list shows them to be entitled. The balance of the stock remaining from said certificates hereinabove last mentioned and such paid up stock subscriptions as have been fully complied with shall be held by you until the termination of this escrow at which time they shall be issued to Frederick Vincent & Company.' " (R. 616.)

Finally the witness conceded that that representation was *not* based upon any books or records seen by him, but only upon information obtained from the testimony given by Stratton. (R. 616-7.)

Stratton, called as a witness for the Government, undertook to support its claim. This evidence of

Stratton was not only refuted by the defendants, but by the very provisions of the escrow agreement, under which the stock was deposited with the Bank of Italy, signed, among others, by Vincent & Company. (R. 281.) The testimony of Stratton in some respects is palpably and knowingly false, as will hereafter be pointed out. However, regardless of this circumstance, Goshorn was not legally justified in using as a basis for his summary or his testimony, *the disputed or any evidence of a witness.* It appears therefore that, although *no book or record* disclosed that any of the McKeon stock had been used to compensate Vincent & Company for market losses, Goshorn deliberately inserted in his first summary, Items 36 and 48 (U. S. Ex. 297) the statement

> "Bank of Italy Escrow—Vincent & Company market losses 125,000 shares" (with reference to each kind of stock)

and while testifying upon direct examination, repeated such representations, it *then* being claimed by him that the summary and his evidence were based upon his examination *only* of books and records.

No better illustration should be required than this to prove that the witness' testimony is only his opinion and conclusion. He might as well have been asked whether in his opinion Stratton was testifying to the truth. If such evidence was inadmissible the summaries and his evidence respecting their representations is equally inadmissible.

Items 29 and 50 (U. S. Ex. 297): The inaccuracy of Exhibit 297 is further shown by the witness' testimony with respect to Items 29 and 50 showing "E. B. Siens

37,057 shares of common and 32,106 shares of preferred". These items would lead anyone to conclude, as Goshorn apparently desired the jury to believe, that Siens actually received such stock. A lack of basis for any such representation is shown by the cross-examination of this witness, his testimony being:

> "I computed these items from Exhibit 228 which shows that E. Byron Siens, on May 13, 1929, mailed to McKeon Drilling Company that stock. I have no knowledge as to whether or not they were actually mailed to McKeon Drilling Company except what the record shows." (R. 621.)

Exhibit 228 consisted of certain ledger sheets of Shingle, Brown & Company pertaining to the McKeon escrow account which reflected the movements of the stock in escrow. (R. 459.) According to Goshorn:

> "The receipt (for these two blocks of stock) is signed by Mr. Siens, although it says it is mailed to the McKeon Drilling Company. I made no investigation at all as to the mailing of that stock to the McKeon Drilling Company." (R. 622.)

Notwithstanding what the evidence disclosed, Goshorn in his summary and testimony, charges Siens with having received the stock. Even if the jury had been entitled to infer distribution to Siens, which we deny, it is obvious that Goshorn's characterization of the delivery of the stock was purely his conclusion.

Item 7, U. S. Ex. 297: Item 7 reads "A. G. Wilkes, 400,000 shares" (common). It indicated to the jury that Wilkes received 400,000 shares of the stock asserted to have been retained by the McKeon Company.

This statement, if believed by the jury, would naturally have prejudiced the McKeons as well as Wilkes. The cross-examination of Goshorn again shows the lack of justification for this item, and that his statement is nothing more than his unfounded conclusion. According to his testimony:

> "I base that statement upon Exhibit 228, the McKeon Drilling Company escrow records kept by Shingle, Brown & Company and to the last ledger sheet headed 'Stock for McKeon Drilling Company' to the entry under date February 15, 1929, which says 'Mail to A. G. Wilkes 400,000 shares of common'." (R. 660.)

He immediately qualifies his testimony, however, by stating:

> "It is not my testimony that that 400,000 shares of common stock went to Mr. Wilkes for his use and benefit. * * * I have not traced those 400,000 shares of common stock. I testified that in many instances the certificate number did not appear. I don't recall those particular shares." (R. 660.)

Upon being shown Exhibit 228 and the sheet headed "A. G. Wilkes" being part of the McKeon escrow records, he admitted that

> *"that exhibit does not show that the 400,000 shares of stock went to A. G. Wilkes.* It shows that the 400,000 shares of stock were charged to the account of the McKeon Drilling Company and not to the account of A. G. Wilkes." (R. 661.)

His attention was then called to Exhibit 113 consisting of the series of letters dated February 15, 1929, and February 19, 1929, stating in substance as follows:

> "that certificates for 400,000 shares of common stock were being mailed to Wilkes at the Biltmore Hotel, Los Angeles, and charged to the McKeon Drilling Company account, to be used as collateral for a bank loan, and *giving the certificate numbers of the stock.*" (R. 661.)

whereupon the witness then testified:

> "I made no examination or investigation for the purpose of ascertaining whether that 400,000 shares of stock described in Exhibit 113 were deposited at the bank as collateral security for a loan to the McKeon Drilling Company, and I made no effort to follow out or trace the certificates of stock the numbers of which appear in Exhibit 113 representing those 400,000 shares." (R. 661.)

And notwithstanding his former testimony that the Shingle-Brown records failed to contain the certificate numbers of certificates distributed, he was compelled to testify:

> "In some instances the escrow records kept by Shingle, Brown & Company of the McKeon stock show that when the stock was distributed to any person the certificate numbers of the certificates distributed appeared. *I do not have in mind right now any particular instance in which the escrow records kept by Shingle, Brown & Company of the McKeon Drilling Company do not show the certificate numbers of stock distributed to any particular person.*" (R. 661.)

Items 17 and 14 (U. S. Ex. 297): Each of these items is designated "Escrow stock substituted for syndicate stock." The first appears under the designa-

tion "*Bonus* Common Stock distributed by McKeon Drilling Company" (Item 16) and the next under the designation "*Bonus* Preferred Stock distributed by McKeon Drilling Company", Inc. (Item 39.) (R. 596-7.)

The court will recall that on account of the commitments made by Shingle, as manager of the so-called big syndicate, it was impossible for the syndicate to sell to Vincent & Company in excess of approximately 122,000 units of Italo stock and that through mistake the auditor of Shingle, Brown & Company had delivered to Vincent & Co. stock aggregating the amount of these two items. (R. 1001.) Unless the commitments thus made by the syndicate manager to the stock brokers with whom arrangements had been made to sell Italo stock for the benefit of Italo, were carried out, it would have been impossible for Italo to have made its payments upon the proposed purchase by it, and financial disaster would have followed. To save the situation the McKeon Drilling Company voluntarily substituted its escrowed stock for the syndicate stock thus inadvertently withdrawn, the sale price of which was paid to it. Why Goshorn assumed to believe that he was justified in characterizing such stock as "bonus" stock is inconceivable. In any event it can be readily understood that such representation, as well as his evidence supporting the same, was purely his opinion and conclusion, a matter solely within the province of the jury to determine. Some of the testimony with respect to this item shows his unquestioned unfairness. Although testifying that he had made an examination of the records of Fred Shingle, syndicate

manager of the big syndicate (R. 659), he further stated:

> "I did not examine the records of the syndicate and do not know whether as of October 15, 1928, options had been given to brokers for 2,500,000 shares of that common syndicate stock, and I do not know how much of the 3,000,000 shares of common stock held by Fred Shingle, as syndicate manager, was under option as of October 16, 1928. * * *" (R. 657.)

Witness' evidence based upon previously prepared questions and answers.

A most remarkable situation was disclosed upon the cross-examination of Goshorn, which would indicate that all of the evidence herein criticized was deliberately and intentionally given. Apparently an attempt was being made to ascertain the basis of the character of evidence being given by him, in response to which he testified:

> "In giving my testimony I did so pursuant to typewritten questions and answers, which I have in my hand." (R. 647.)

Exhibit 299: Summaries respecting Brownmoor Oil Co.

An identical situation will be disclosed by an examination of U. S. Exhibit 299 (R. 636-9) and the testimony of the witness addressed to the two summaries contained in that exhibit. (R. 640-3.) Reference to some of the items appearing upon this exhibit will suffice to establish the proposition just asserted.

Admission of witness respecting conclusions.

That the matters appearing upon this exhibit, as well as Exhibit 297 were his conclusions, the witness testified:

> "The designation given to various matters contained on exhibits 297 and 299 is my conclusion." (R. 646.) * * *
>
> "*My conclusions* in Exhibit 299 are based upon the stock certificate book of the Brownmoor Oil Company and the contract between the Brownmoor Oil Company and the Italo Petroleum for the payment of the 600,000 units." (R. 647.)

Making mention of Item 2 (Ex. 299) as follows: "*Bonus* given to members of the $80,000 syndicate", the witness testified:

> "The expression *'bonus given'* is my conclusion. *The books and records do not disclose the word 'bonus' and do not disclose whether it was given or not.* The books say it is but part of the consideration for the $80,000." (R. 676.)

Specific items demonstrating conclusions.

The first summary in Exhibit 299 purports to deal with the 600,000 units of Italo stock issued to Brownmoor Oil Company for its assets. Preliminarily it may be stated that the title to the chart is itself prejudicially misleading, because by the use of the words "issued in acquiring the properties of the Brownmoor Oil Company" the impression is created that the Italo Company issued to the defendants and other individuals mentioned in the summary, the shares of stock purported to have been received by

them, when, as a matter of fact, the stock was issued to the Brownmoor Oil Company, and by it, under a permit issued by the Corporation Commissioner, delivered to its stockholders in exchange for their certificates of stock. (R. 511.)

Item 2. *"Bonus given to members of $80,000 syndicate 40,000 common, 40,000 preferred stock* (R. 636): The court will recall that 40,000 units of the stock were exchanged by the Brownmoor Oil Company for the 80,000 shares of its stock, assigned by Vincent & Company, as consideration for the loan of $80,000 to Italo by Fred Shingle, syndicate manager. In dealing with this stock, the witness characterized it as "bonus" given to the members of the $80,000 syndicate (R. 636) the impression given to the jury being that it was promotion stock. We have already shown that according to his own testimony, this was purely his conclusion and opinion. (R. 676.)

Furthermore, under the caption to the chart above referred to, the jury undoubtedly concluded that the 40,000 shares, represented part of the so-called "bonus" stock, claimed to have been issued by Italo, and that it was furnished by Italo to the syndicate manager. That such was not the fact was conceded by Goshorn, upon cross-examination, where he testified:

> "Italo Petroleum Corporation of America never put up the 40,000 shares of Brownmoor Oil Company stock that became the bonus stock for the $80,000 loan syndicate." (R. 651.)

That the loan agreement between the Italo Company and the syndicate manager did not provide for the

payment of any bonus stock was stipulated by the Government. (R. 649.)

Item 4. *Horace J. Brown, 1250 common, 1250 preferred shares:* Upon this item as well as by his testimony on direct examination, the witness undertook to convey to the jury the belief that the defendant Brown was a subscriber to the $80,000 syndicate and was given 1250 units of Italo (bonus) stock. On cross-examination the witness admitted:

> "With reference to the next name, 'Horace J. Brown, amount subscribed $2500', Mr. Brown paid it. On Exhibit 142 opposite the name Horace J. Brown is the notation 'Paid, O. B. Wilkes'. That would indicate to me that the Brown subscription was paid by O. B. Wilkes. I do not know whether the stock that was issued in the name of Horace J. Brown in that syndicate was actually transferred to the party named O. B. Wilkes and received by her. I did not make any effort to ascertain whether that stock did go to O. B. Wilkes but left it in the name in which the certificate stood." (R. 652-3.)

It is obvious that the item, as well as the evidence of the witness, reflected only his conclusion, because the record establishes without contradiction that the subscription of Brown was taken over by Mrs. O. B. Wilkes who received the stock referred to by the witness. (R. 968-9.)

Items re R. L. Mikel and Axton F. Jones (Ex. 299): Items 4 and 5 of the first summary appearing in Exhibit 299 occupy the same situation as the item just discussed. Each of the subscriptions of Mikel and Jones was assigned to Perata by whom the subscrip-

tions were paid and to whom the stock was delivered (R. 837; 887-8), yet the name of Perata does not appear upon the summary. The exhibit upon which this portion of the summary was based was Exhibit 142, with respect to which the witness testified:

> "With respect to Exhibit 142 the subscriptions of Rossiter Mikel and Axel F. Jones each for $2500, I did not conduct an investigation to ascertain whether those two subscriptions or any part of them was assigned and transferred to any other person. The notation on the side there is 'Paid Perata'." (R. 653.)

The representations on the summaries and the testimony of Goshorn with respect to this and the preceding item were obviously unfair to Brown, Jones and Mikel, because they purported to show, and they conveyed to the jury the information that the three defendants mentioned received such bonus stock, when as a matter of fact, as the records in evidence show, and the witness knew, the subscriptions had been transferred to, and the stock received by other persons.

Item 11 (Ex. 299): *Fred Shingle 230,000 shares common, 230,000 shares preferred.* (R. 637.) This item is without the slightest justification. That it had an effect upon the jury prejudicial to defendants must be conceded. It relates to the stock issued without the knowledge of Fred Shingle and his name was endorsed upon the certificates by Vincent without Shingle's knowledge or authority. This is established by the evidence beyond the shadow of a doubt. (R. 277.) It was conceded by Government witness Vincent, who testified:

"This 230,000 units of stock was Italo stock and not Brownmoor stock. The receipt 'Exhibit 38' signed by Fred Shingle, dated June 1, 1928, is signed by me. The words 'Fred Shingle' are in my handwriting on that receipt. I don't remember the circumstances under which I placed my handwriting on these receipts." (R. 440.)

That all of the circumstances surrounding the transaction relating to the 230,000 units of stock was well known to the witness is shown by his testimony:

"From my examination of the records of Shingle, Brown & Company, and particularly the ins and outs, I did not find any record of the receipt by Shingle, Brown & Company of certificates representing 230,000 units of the Italo Petroleum Corporation of America which has been referred to here in evidence as having been issued in the name of Fred Shingle. I found no record whatever in the books of the receipt by that company of those certificates of stock. I did not find any record of Shingle, Brown & Company where that company, as a brokerage transaction, had any sale or confirmation of sale of those certificates representing 230,000 units of stock that stood in the name of Fred Shingle. (R. 654-5.) * * * I did not find any record of Shingle, Brown & Company or the Montgomery Investment Company which showed the receipt of those 230,000 units of stock." (R. 655.)

The witness was then examined upon Defendant's Exhibit E, being the penciled memorandum written by Stratton, one of the partners in Vincent & Company, whereupon he stated:

> "By referring to Defendant's Exhibit E and government Exhibit 171, it is a fact that Frederick Vincent & Company bought the 450,000 shares of Brownmoor Oil Company stock referred to in the letter (Ex. 171) and paid therefor the sum of $110,000. The equivalent cost of that stock in units of stock would have been 91,666 units. The 230,000 units of stock receipted for by Frederick Vincent in signing Fred Shingle's name to Exhibit 38 was distributed to various and sundry persons according to the stock transfer records of the Italo Petroleum Corporation, those persons being designated by Frederick Vincent & Company. No part of those 230,000 units of stock went back to or in the name of Fred Shingle." (R. 656.)

This is not only a flagrant case of misrepresentation, but again proves the contention of defendants that the items upon the summaries are merely opinions and conclusions of the witness, in some instances based upon only such portions of the evidence to which he saw fit to give consideration, and in other instances having no evidentiary basis whatever.

Some of the remaining items in Exhibit 299 are subject to similar criticism, but further reference would unduly prolong this section of our brief. In order, however, to convince this court that we are not unnecessarily harsh in our criticism of Goshorn and his testimony we desire to draw its attention to two other phases of his testimony. U. S. Exhibit 298 (R. 633) is a summary prepared by Goshorn purporting to represent the stockholders of the Brownmoor Oil Company as of the date of the sale of its assets to

Italo. According to Goshorn's testimony it was compiled from the "stock certificate book" of Brownmoor and he states he had

> "computed and included in this schedule the number of shares of Italo stock those Brownmoor stockholders were entitled to receive respectively because of the sale of the Brownmoor assets to Italo Petroleum Corporation of America." (R. 631.)

It will be observed that this exhibit does not disclose the issuance of 80,000 shares in the name of Fred Shingle or 420,000 shares in the name of E. Byron Siens. The unfairness and lack of integrity of Goshorn's schedule is disclosed throughout his cross-examination thereon. Upon cross-examination he testified:

> "The Merchant's National Bank, now Bank of America, was the registrar and transfer agent for the Brownmoor Oil Company." (R. 650.)

Thereupon U. S. Exhibit 147 for Identification was received in evidence, whereupon the witness continued his cross-examination as follows:

> "I *saw these ledger* cards that are a part of Exhibit 147 but did not make a detailed audit of them."

The records of the Brownmoor Oil Company produced by the Bank of America, registrar and transfer agent for Brownmoor Oil Company, show that there was deposited by E. Byron Siens certificate for 500,001 shares of the capital stock of the Brownmoor Oil Company with instructions to issue 80,000 shares there-

from in four certificates of 20,000 shares each in the name of Fred Shingle, and the remaining stock, consisting of 220,001 shares in the name of E. Byron Siens. Exhibit 147, the stock ledger card, shows that on May 3, 1928, certificates Nos. 1, 2, 3 and 4 for 20,000 shares each of the capital stock of the Brownmoor Oil Company were issued in the name of Fred Shingle. Exhibit 147 further shows that as of February 21, 1928, E. Byron Siens was a stockholder in Brownmoor Oil Company represented by certificate No. 60 for 500,001 shares which was surrendered May 3, 1928, and thereupon certificate No. 6 for 420,001 shares of the capital stock of the Brownmoor Oil Company was issued in the name of E. Byron Siens. (R. 650-1.)

Another instance of this character is shown by Goshorn's testimony respecting the capitalization of the Brownmoor Oil Company. Upon cross-examination he testified that on the date of the Brownmoor-Italo contract its capitalization was 1,000,000 shares. (R. 648.) The fact is that on December 13, 1927, a resolution was adopted by the board of directors of the Brownmoor Company authorizing the increase of its capital to 2,000,000 shares of stock. No mention of this resolution was made by the witness although it was enacted prior to the Brownmoor-Italo transaction.

(b) Summaries contained in U. S. Ex. 297 based in part upon records not in evidence.

That the exhibit itself as well as the details of the summaries appearing therein was in part based upon the books and records of Wilkes-Cavanaugh, a part-

nership, none of which were introduced in evidence, is conceded, the witness testifying:

> "I have examined the books and records in evidence, *and the books and records of Wilkes and Cavanaugh, partners,* that I have just described, for the purpose of ascertaining the disposition of the 4,500,000 shares of stock issued by the Italo Petroleum Corporation of America for the assets of the McKeon Drilling Company, Inc., and of ascertaining the amount of money and stock realized by the defendants from that 4,500,000 shares of stock. From the examination I have ascertained and prepared a summary reflecting the disposition of the stock based on the records and books in evidence *and the books and records of Wilkes-Cavanaugh partnership.* * * *" (R. 590-1.)

Later on he testified:

> "These records are all in evidence except the books and records of Wilkes and Cavanaugh partnership." (R. 610.) See also page 612.

Still later he testified:

> "* * * The books of Wilkes-Cavanaugh partnership were examined by me and I used them as a basis for my testimony, *but those books and records are not in evidence.*" (R. 645.)

(c) Exhibit 297 and evidence of Goshorn in part based upon assumed truth of oral evidence of Stratton.

As has already been pointed out, on cross-examination the witness Goshorn admitted that his conclusion that Items 36 and 48 (U. S. Ex. 297) purporting to show alleged bonus stock aggregating 150,000 shares given Vincent & Company to compensate

it for market losses was based *solely* upon the testimony of Stratton, his testimony being:

> "That information was obtained from the testimony of Mr. Stratton. (R. 616.) * * * The statement on my summary (Ex. 297) that the stock was to cover market losses *is not based upon any books or records that I saw,* but the information was obtained from the *testimony* of Mr. Stratton." (R. 616-7.)

ARGUMENT.

Exhibits 297 and 299 and the evidence of Goshorn relating thereto were inadmissible upon the ground that they represented his opinions and conclusions.

In our opinion no argument is necessary to convince the court that Exhibits 297 and 299 and the evidence of the witness Goshorn respecting the contents of these exhibits should have been rejected upon the ground that they reflected solely his opinion and conclusion and that the admission of such evidence invaded the province of the jury to the prejudice of defendants. We are not unmindful of the rule that when contents of *writings* consist of numerous accounts or other documents which cannot be examined in court without great loss of time and the evidence sought from them is only the general result of the whole, under certain circumstances the evidence of an expert accountant is admissible to establish tabulations made from such writings. If the testimony of the witness Goshorn had been confined to such evi-

dence, objection thereto would not have been made. The evidence of Goshorn, however, was not thus limited, but related to the controlling issues of fact that were to be determined solely by the jury.

In the indictment it was charged, among other things, that although the Italo paid to the McKeon Company 4,500,000 shares of its capital stock for its assets, which it asserted was far in excess of the value of its properties, there existed a secret arrangement whereby certain defendants should receive back from the McKeon Company 2,500,000 shares of its stock, which stock should be sold and the proceeds converted to their own use and benefit, and to the exclusion of the use and benefit of the Italo Company and its stockholders. (R. 34-5.) Comparable allegations were made respecting the Italo stock which was transferred to the Brownmoor Oil Company in consideration for its assets. (R. 29-31.) It was further charged that the doing of these things was contemplated by and constituted a part of the alleged conspiracy.

No direct evidence was introduced by the Government tending to establish any such conspiracy, it being claimed that its existence could be inferred from the transactions that actually occurred, including the sale and purchase of the assets, among others, of Brownmoor Oil Company and McKeon Drilling Company. Whether the charges thus made against defendants were in accord with the truth was a matter exclusively for the determination of the jury from the evidence before it. Whether the 2,500,000 shares of McKeon Drilling Company stock was "bonus" or "promotion" stock, or whether it on the contrary belonged to

the McKeons and it or its proceeds were used for the purposes and benefit of Italo and its stockholders were matters of vital importance to defendants. Upon the determination by the jury of these matters was staked the liberty of the defendants. To permit an accountant or any other witness to testify that either the whole or any part of this stock was *"bonus", "commission"* or *"promotion"* stock and to characterize the purpose for which the stock or its proceeds was used, or to state, in effect, that the stock or its proceeds was converted to the use and benefit of a defendant, was the determination by the witness of the ultimate facts in issue to be passed upon solely by the jury.

The error of the trial court in admitting this testimony, as well as its effect upon the jury, was exaggerated and intensified by the further fact that over defendants' objections these exhibits were taken into the jury room to be read and examined by the jurors during their deliberations without even having been corrected as to the word "bonus" as directed by the court. That under the rules of evidence universally recognized and constantly adhered to, the admission of this evidence was prejudicial error, must be conceded.

Authorities.

The legal proposition involved is elementary. The case of *Hanson v. Pauson,* 25 Cal. App. 169, is squarely in point. One of the issues in the case was whether certain stock had been issued as *bonus* stock, or whether it had been merely pledged as security for a loan. A witness was asked whether such stock was bonus stock. The court held that, although the wit-

ness could narrate facts disclosing the circumstances under which the stock was issued, he could not testify as to whether the stock was "bonus stock" or otherwise characterized. In so deciding, the court said:

> "At its best, his answer embodied no more than his mere conclusion as to the result of some undisclosed action which may have been taken by the officers of the corporation concerning the issuance of the stock in question. A witness may not testify as to his conclusions concerning the effect of the transaction, even where the facts themselves are disclosed; and surely he should not be permitted to give in evidence his conclusions, adduced from undisclosed facts and circumstances. The *legal effect of the issuance of the stock to the defendant was the paramount point in controversy in the present case,* and this was a question which should have been decided by the trial court upon a consideration of the facts of the transaction, whatever they may have been, unaided and uninfluenced by the conclusion of the witness. The motion to strike out the answer complained of should have been granted." (Italics ours.)

In *Wilson v. Hotchkiss,* 21 Cal. App. 392, 398, it was held that a question

> "I will ask you whether you at any time treated the stock otherwise than as security for the indebtedness which you claim to be owing from Mr. Wilson to you"

was improper as calling for the conclusion of the witness.

In *Winslow v. Glendale Light & Power Co.,* 164 Cal. 688, the question involved was whether the plaintiff

was injured, as the result of the negligence of the defendant or an alleged independent contractor. One of the men employed by the alleged independent contractor, on cross-examination, was asked the question

> "By whom were you employed and for whom were you working on February 27, 1907?"

(the date of the accident) and made answer

> "for the Glendale Light & Power Company."

He further testified that he was on duty, on the date of the accident for "the Glendale Light & Power Company". In reversing a judgment in favor of the plaintiff, the court, speaking through Mr. Justice Henshaw, held that the evidence was nothing more or less than the conclusion of the witness and legally insufficient to justify the verdict of the jury based thereon.

In *Dunlap v. Sunset Lumber Co.,* 26 Cal. App. 131, it was held improper to inquire of a witness whether certain stock was issued "in consideration" of the execution of a note and mortgage.

In *In Re Pepper's Estate,* 158 Cal. 619, the decision of the lower court in preventing a witness from testifying as to whether certain property was community property, was upheld.

In *Hirning v. Lifestock National Bank* (8th Cir.), 1 Fed. (2d) 307, 310, the action of the lower court in sustaining an objection to a question

> 'Whether the plaintiff bank received any part of the proceeds of the Taylor note"

on the ground that it called for his conclusion, was upheld.

It has been repeatedly held that the opinion of a witness upon the ultimate conclusion to be decided by the jury and drawn by it from the facts and circumstances in evidence is inadmissible.

In

Pioneer Lumber Co. v. Van Cleave, 279 S. W. (Mo.) 241, 245,

it was held that although an expert accountant may testify to the result of an examination of books, papers and records, which are properly in evidence, or their absence satisfactorily explained, "he may *not* be permitted to express his opinion as to the ultimate issue in the case".

In

Smythe's Estate v. Evans, 70 N. E. (Ill.) 906,

it was held that in an action on a contract to recover a share of the profits realized by a contractor in the construction of a plant, an expert accountant may show the jury the result of footings, etc., but cannot state the amount of the profits, that being a conclusion, which is for the jury to determine.

In

People v. Durant, 116 Cal. 179 at p. 217,

it was said:

> "Where the ultimate conclusion is one to be reached by the jury itself from the facts before it, and so-called expert evidence is allowed, which presents to a jury a conclusion other than that to which they might have arrived, the admission of this improper evidence is tantamount to a declaration by the court that they may set aside their exclusive right of judging and accept the judgment of the expert. In such cases injury is apparent."

Without incorporating herein additional quotations from decisions, we invite the court's attention to the following authorities, all of which are to the same effect.

People v. Westlake, 62 Cal. 303 at 309;
People v. Milner, 122 Cal. 171;
People v. Farley, 124 Cal. 594;
Lim Ben v. Pacific Gas & Electric Co., 101 Cal. App. 174;
Hatch v. U. S., 34 Fed. (2d) 436;
Shwab v. Doyle, 269 Fed. 321 at 333;
Merritt v. U. S., 264 Fed. (9th Cir.) 870;
Menefee v. U. S., 236 Fed. (9th Cir.) 826;
Spokane & I. E. R. Co. v. U. S., 241 U. S. 344, 60 L. ed. 1037;
Standard Fire Extinguisher Co. v. Heltman, 194 Fed. 400.

Some of the cases above cited hold that even the evidence of an expert upon such subject would be inadmissible. In the instant case, the question as to whether the evidence objected to was the subject of expert evidence was not involved, not alone because it was not claimed to be so-called expert evidence, but the witness himself was called merely as an accountant and not as an expert.

Exhibits 297 and 299 and the evidence of Goshorn relating thereto were inadmissible because based in part upon books and records not in evidence.

We have shown that it was both testified to by Goshorn and conceded by the prosecution that his

summaries in evidence were based in part upon the books and records of the Wilkes-Cavanaugh partnership. These books and records, even though produced in court, under well recognized legal principles would have been inadmissible in evidence as against any defendants other than Wilkes and Cavanaugh. This legal proposition is given consideration in Point III and will not be given attention here. Assuming, however, for the purposes of this discussion the admissibility of such books, if produced in court, the summaries in evidence based thereon were inadmissible.

Both Wilkes and Cavanaugh were defendants in this action represented by counsel entirely independent of the attorneys for John and Robert McKeon, as well as certain other defendants. While the books of this partnership were available to the defendants Wilkes and Cavanaugh they were never in the possession of or made available to any of the other defendants.

While under proper circumstances a witness may be permitted to testify to the contents of numerous accounts or documents which cannot be examined in court without great loss of time and which have not been admitted in evidence, such evidence is an exception to the general rule and under no circumstances is such evidence admissible unless the books or documents from which the summaries are compiled are either in court or made available to the party against whom they are offered. Each defendant on trial was asserting his own innocence. No defendant, other than Wilkes and Cavanaugh, had a right to demand the production of or be given access to these partner-

ship books. To have permitted Goshorn to introduce into evidence Exhibits 297 and 299 and his testimony relative thereto in the absence of a foundation charging the defendants with knowledge of the contents of the books and records or being accorded the opportunity of examining or having access thereto, was unquestionably reversible error.

Authorities.

If, under the circumstances here shown, summaries were admissible, it would follow that no necessity would exist to introduce in evidence *or make available to the opposing parties* books or records, upon which such summaries are based. In a criminal case, the prosecution could develop its case, through the evidence of the accountant who examined the books and through summaries prepared by him and, without introducing the books in evidence, *or making them available to the defendants,* could effectually prevent the defendants from cross-examining the witness, and from contradicting or impeaching him by the books examined, or by even opposing the evidence by the testimony of their own accountants or experts. A mere statement of the proposition itself demonstrates that such procedure should not be tolerated in any court of justice.

An examination of the decisions will disclose that in every instance where the books, upon which the tabulation and the evidence of the witness were based, were not in evidence, the court required that they either be produced in court or be made available to the defendants and their counsel as a condition precedent

to the admission in evidence of such tabulations or the giving of evidence by the accountant.

In *Northern Pac. R. Co. v. Keys* (Cir. Ct. North Dakota), 91 F. 47, 59, a large number of tables prepared in the accounting departments of the various railroads involved, were introduced in evidence. The records, upon which the tables were based, were present as were also the clerks by whom the tables were prepared. According to the decision

> "counsel for the defendants was invited to call any of the clerks for the purpose of cross-examination and was given the freest access to all the papers and records from which the computations were made." (58)

In holding the tables admissible the court said:

> "The method adopted was the only practicable one for conducting the investigation. It would have been absolutely impossible for any one man to have compiled the general result without delaying the case for years. *A reasonable safeguard against falsification in the preparation of such statements is furnished by placing the records from which they are compiled freely at the disposal of the adverse party.* IT WAS THE DUTY OF THE COMPANIES TO DO THIS AND TO GIVE THE ATTORNEY GENERAL THE FULLEST ASSISTANCE IN EXPLAINING SUCH RECORDS AND TO ALLOW HIM TO PLACE THE SAME IN THE HANDS OF EXPERT ACCOUNTANTS IF HE SO DESIRED FOR THE PURPOSE OF DETECTING ERROR OR FALSIFICATION IN THE TESTIMONY AS PREPARED BY THE COMPANIES. The record shows that this was done throughout the taking of the testimony in these cases." (59)

In

Lemon v. U. S. (8th Circuit), 164 Fed. 953,

at page 960, it is said:

> "Ira D. Oglesby, who had been appointed receiver of the assets of the trust company and who had familiarized himself with its books of account and the value of its assets, was introduced as a witness on behalf of the government. *The books of account were in court and subject to the inspection and use of the defendant's counsel.* UNDER SUCH CIRCUMSTANCES it was not error to permit the receiver to summarize the contents of the books. * * * *The defendant's rights were sufficiently safeguarded by the presence of the books in court and by the right to use them freely in cross-examination.*"

In

Hooven v. First National Bank, 134 Okla. 217, 273 Pac. 257,

the rule is thus stated:

> "We realize that the use of summaries is an exception to the rule and countenanced only by reason of necessity and convenience; *a safeguard and* PREREQUISITE *is the production of the originals in court and an opportunity for inspection of them by the adverse party.*"

In

Kinney v. Maryland Casualty Co., 15 Cal. App. 571, at page 575,

the necessity for the books being in court and made available to defendants is clearly pointed out, the statement being:

"The books being in court *through the use* of which upon cross-examination the accuracy of such statements could have been determined * * * would indicate that no prejudicial error could be said to result from the action of the court in permitting the memorandum for the purposes for which it was used." (Italics ours.)

See, also:

Hagan Coal Mines v. New State Coal Co., 30 F. (2d) 92, at 93;

State v. Rhodes, 6 Nev. 352;

State v. Findley, 101 Mo. 217, 14 S. W. 185;

Edelen v. Muir, 163 Ky. 685, 174 S. W. 474.

In

Wigmore on Evidence, par. 1230, page 1473,

the rule is thus stated:

"Most courts require as a condition that the mass thus summarily testified, shall, if the occasion seems to require it, be placed at hand in the court *or at least be made accessible to the opposing counsel in order that the material for cross-examination may be available.*"

These authorities can readily be multiplied. In each instance it will be found that where summaries were admitted in evidence based upon books and records not in evidence, such books and records were either in court or made available to the opposing parties.

Exhibit 297 was inadmissible because based in part upon the assumed truth of the oral evidence of Stratton.

The admission in evidence of a tabulation can be justified only upon the ground that it represented the general result

> "of numerous accounts or other documents which cannot be examined in court without great loss of time."

No precedent or rule of evidence can be cited which would justify the admission in evidence of the tabulation based in whole or in part upon the oral testimony of a witness, particularly one whose evidence, at least in some particulars was proven to be false, and yet U. S. Exhibit 297 conceded to have been so founded, against the protests and over the objections of defendants, was not only received and permitted to remain in evidence, but was turned over to the jury for consideration during its deliberations. That in this respect the trial court committed error is unquestioned.

VII.

THE COURT ERRED IN OVERRULING DEFENDANTS' OBJECTIONS TO THE WHOLE OF EXHIBIT 155 BEING TAKEN INTO THE JURY ROOM AND CONSIDERED BY THE JURY DURING ITS DELIBERATIONS UPON THE GROUND, AMONG OTHERS, THAT THE PORTION OF SAID EXHIBIT NOT IN EVIDENCE SHOULD HAVE BEEN DELETED THEREFROM BEFORE BEING GIVEN TO THE JURY; AND FURTHER THAT SUCH EXHIBIT HAD BEEN INTRODUCED ONLY AS AGAINST DEFENDANT WESTBROOK AND THE JURY SHOULD HAVE AGAIN BEEN CAUTIONED TO CONSIDER IT ONLY AS TO SUCH DEFENDANT. (Assignment of Error No. 57, R. 1485.)

Exhibit 155 was a statement made under oath (affidavit) on November 12, 1929, by defendant Westbrook to Special Agent Cornelius of the Bureau of Internal Revenue, relative to the net income of defendant E. Byron Siens. (R. 435-7; 1485-6.) A *portion* of this statement was introduced in evidence as against the defendant Westbrook only, the portion introduced alone being read to the jury. (R. 436-7.) That portion of the exhibit which was not read to the jury was ordered stricken out by the court (R. 436-7.)

The proceedings with reference to the delivery of the affidavit to the jury (R. 1335-40) may be briefly summarized as follows:

The jury, after having the case submitted to them, and having retired, transmitted to the court a request in writing for the delivery of certain enumerated exhibits including the said Exhibit 155. (R. 1335.) Defendants' counsel objected to the affidavit being delivered to the jury upon the ground that

"it contained matter that had been ordered stricken from the evidence and was therefore not in evidence." (R. 1335.)

And upon the further ground

"that the said statement had been admitted in evidence *only* as against the defendant Westbrook and the jury should be specifically instructed that they were not to consider the said statement * * * as against any defendant other than the defendant Westbrook." (R. 1335.)

The trial court overruled the objections thus made and ordered the *entire* exhibit, including the stricken portion, delivered to the jury for consideration by it during its deliberations, to which ruling the defendants excepted. (R. 1340.) That portion of the verified statement that had been stricken from the evidence during the trial was in substance as follows:

That the affiant understood that the defendant Wilkes and the defendant Siens were building a yacht that was costing $100,000; that the defendant Siens admitted to them that he owed the government money on prior years' tax liability; that he had made an offer of compromise to the government, but that the government "found out something and would not settle"; that the defendant Siens wanted the affiant to make his return to conform to Siens' return and *that they both could save income taxes by falsely charging off moneys purporting to have been invested and lost in the Brownmoor transactions,* but which had not in fact been so invested and so lost; that the fake transaction could be given the color of legitimacy through an arrangement with one Shreve of San Diego. (R. 1335-7.)

That the Shingle syndicate formed to acquire certain oil properties in California for the Italo Petroleum Corporation was successfully organized *and that he believed the members had made a large profit;* that he believed the moneys raised by the syndicate were "to pay off the indebtedness of the Italo and assume 12,000,000 shares of Italo stock and pay off in cash and stock, for various oil properties that the Italo had purchased, *leaving a residue of a large number of shares which would belong to the syndicate and if sold ought to return from 5 to 10 to 1.*" (R. 1335-1337.)

It is the contention of appellants that the court erred:

1. In directing that the Westbrook affidavit be taken into the jury room to be considered by the jurors without first deleting therefrom the portion not admitted in evidence, and

2. In refusing to instruct the jury when the affidavit was delivered to them that they were to consider it only as against the defendant Westbrook.

These two propositions will be given attention in the order stated:

1. The court erred in directing that the Westbrook affidavit be taken into the jury room to be considered by the jurors without first deleting therefrom the portion not admitted in evidence.

It seems to us that in the absence of any bias or prejudice on the part of the trial judge, before directing that the affidavit should be delivered to the

jury he would, and should, have adopted the safety factor of having covered that portion of the statement which the jury was not to consider, or have adopted the more proper course of bringing the jury into court and having read to them the portions of the exhibit which were in evidence; and had the rights of the defendant been considered, the court at least would have taken the precaution of instructing the jury that they must disregard the portions of the affidavit that had been stricken from the evidence, and would also have instructed the jury, *as requested by defendants,* that they were to consider such exhibit only with reference to the defendant Westbrook. (R. 1335-1340.)

Jury's inability to differentiate between portions of statement admitted and excluded.

It must be apparent to this court that considering the character and complexity of the issues involved, the great length of the trial, and the numerous and involved character of the exhibits introduced, it would have been humanly impossible for the jurors at the conclusion of the trial, while deliberating upon their verdict, to differentiate between portions of exhibits which were introduced in evidence and those portions which were rejected. To assume such ability on the part of the jury would be to credit its members with superhuman attributes.

Having in mind that the basis of the various charges contained in the indictment aimed at the defendants, was an alleged scheme to defraud by the division of profits and stock among the defendants, it necessarily follows that any statement, particularly

the *verified* statement of a defendant on trial, which imputed unlawful practices and dishonest motives to any of the alleged conspirators and which referred to an alleged division of the stock referred to in the evidence and profits therefrom, must have had a very prejudicial effect upon the jury when considering the fate of each and every defendant.

Error to deliver to the jury a document not in evidence.

It would seem to be stating the obvious to argue that it is error to order taken into the jury room for the consideration of the jury, documents not admitted in evidence. By the delivery to the jury of the Westbrook affidavit the trial court frustrated its very purpose in striking out and excluding from the evidence those portions of the statement which it deemed, and the United States District Attorney conceded, were inadmissible.

The curiosity of jurors respecting the contents of written documents excluded from their consideration is universally recognized. The very fact that objection is made thereto, in and of itself, ofttimes creates a prejudice in their minds against the client represented by the objector. Even though it were assumed that the jurors recalled that but a portion of the affidavit was in evidence, it would be impossible to further assume that their consideration was limited to such portion. That jurors frequently complain that they would be better qualified to decide cases submitted to them, if they had the benefit of evidence excluded by the court, is known to every judge and trial lawyer. That jurors, constantly dominated by

the belief that excluded evidence is evidence harmful to the objector, would refuse to examine such excluded evidence if it comes within their grasp, is incredible.

The law on the point as declared by the courts is clear and decisive. To a few of the leading cases upon this subject we will now direct the court's attention.

In the case of

Bates v. Preble, 151 U. S. 149, 38 L. Ed. 106, the plaintiff was endeavoring to recover from a stockbroker the value of securities which were stolen from plaintiff's safe deposit by her minor son and delivered to and sold by the defendant stockbrokers. The plaintiff kept a memorandum book; in which, among other things, were listed her securities. The trial court, in considering the offer of the book in evidence and after an examination of it, excluded a number of pages from the evidence and admitted the remainder, and the book was marked as an exhibit. At the close of the trial, the jury were permitted to take the book into retirement with them *without any sealing of the pages which were not admitted in evidence,* though the court *did* in that case instruct the jury to disregard the parts which were not in evidence.

The resultant verdict was against the defendants, and the Supreme Court, having before it for consideration the defendants' claim that the delivery of the entire diary, including the excluded evidence, to the jury was error, reversed the case, holding that

the delivery of the *entire* book to the jury was error, which was not cured by the trial court's admonition to the jury to disregard the portions not in evidence. In reversing the judgment the court said:

> "Such instruction might have healed an error, if the contents of the books had been unimportant. But the objectionable portions in this case were such as were likely to attract the eye of the jury, and accident or curiosity would be likely to lead them, despite the admonition of the court to read the plaintiff's comments upon the defendants and her private meditations, which had no proper place in their deliberations."

The legal proposition under discussion was given attention by this court in the case of

Alaska Commercial Co. v. Dinkelspiel, 121 Fed. 318.

There a copy of certain receipts marked for identification but not introduced in evidence had been permitted to be sent to the jury room. In holding reversible error had been committed this court said:

> "In view of all of these considerations it is impossible to escape the conclusion that to permit the exhibit to go to the jury as evidence was error for which the judgment must be reversed. We are unable to say how much the jury may have been influenced by such evidence in finding their verdict. *It is enough to say that they may have been influenced by it.*" (Citing *Bates v. Preble,* 151 U. S. 149, *Vicksburg etc. Co. v. O'Brien,* 119 U. S. 919.)

In

Ogden v. U. S., 112 Fed. 523,

it appeared that when the jury was retiring to deliberate upon its verdict an officer handed them the indictment upon the back of which had been endorsed the fact that upon a former trial the defendants had been found guilty. It was not shown that the jurors read such endorsement. In reversing a judgment of conviction because of the circumstance just referred to, the court said:

> "It is, however, contended by the counsel for the defendant in error that it is not shown by the depositions taken that the indorsements on the indictments were read by any of the jurors. The fact that papers with such indorsements upon them were handed to the foreman of the jury, presumably by authority, along with other papers, by an officer of the court, could hardly fail to give to the jury the impression that they were intended for their consideration and that they were expected to have some weight in forming their verdict. We do not think it was necessary on the part of the defendant below to show that such endorsements had been read by the jurors or any of them. It was a gross violation of the rights of the defendant below that they should have been handed to them at all in the manner in which they were. *Trial by jury is properly surrounded by every reasonable safeguard, to insure the absence of any improper influence that might operate upon the minds of the jurors, and give to their verdict the dignity and respect so important to be maintained in the interests of an*

impartial administration of justice. It was not necessary, therefore, in our opinion, that the defendant below should have gone further than he did, when he showed the presence in the jury room of the indictments with the obnoxious endorsements, and the circumstances under which they came into the possession of the jury. Whether proof that these indorsements were not read by any of the jury would have brought us to a different conclusion need not be considered. If it would have had such an effect, the burden was upon the defendant in error to produce the proof. The presumption that their presence in the jury room, under the circumstances, was injurious to the defendant below, remains until rebutted by evidence on the part of the plaintiff below.

We could rest this view of the matter upon the exceeding importance of guarding every approach by which improper influence may reach the jury room, and it would much diminish the efficiency of these safeguards if we were to require the aggrieved party to a suit, to not only show that obnoxious and prohibited documents or other evidence were in the possession of the jury, but that the jurors had actually availed themselves of the opportunity thus presented to them by reading or discussing the same. * * * While the proof of the fact that a document was not only in the possession of the jury, but was read by them, when considered abstractly, may not transgress the line of separation between what a juror may and may not testify to, it would be very hard in practice to so guard the testimony as to the fact of reading from trespassing upon

the forbidden ground of the effect of the reading on the making up of the verdict.

What we take to be the correct rule in this regard is not without support in decided cases, and none have been cited to us by the defendant in error clearly in conflict therewith." (Citing cases.)

The precise question involved here arose in

Kalamazoo Novelty Mfg. Co. v. McAllister, 36 Mich. 327,

"Where an entire book was suffered to be taken to the jury room, when but three pages were in evidence, and it was held that the instruction not to look at the unproved part should not be taken as relieving its admission to the jury room, from error."

In the case at bar, as we have already pointed out, the trial court did not even see fit to give the defendants the doubtful benefit of an instruction to the jury to disregard the stricken portions, although requested so to do.

Decisions, comparable to that rendered in the *Bates v. Preble* case have been rendered by courts of final resort in many states, to but a few of which we will here refer.

In the case of

Lurie v. Kegin Grace Co., 96 So. 344, 345 (Ala.),

it was held that it was error to permit the jury to take with them to the jury room a deposition, parts of which were excluded from the evidence (the ex-

cluded parts having been enclosed in brackets), even though the court instructed the jury to disregard the portions which were enclosed in brackets, *and the case was reversed upon that ground alone.*

In

Rich v. Hayes, 54 Atl. 794 (Maine),

the jury were permitted to take with them not only a letter, which was introduced in evidence, but a memo which was attached to it, which was not introduced in evidence, and this was held reversible error.

In

Sargent v. Lawrence, 40 S. W. 1075 (Tex. Civil Appeals),

a land office certificate was placed in evidence with portions thereof excluded, and when the jury retired, it was permitted to take with them the entire certificate, without any admonition with reference to the excluded portion, and here again it was held error, the appellate court stating that the trial court should not have permitted the jury to take the document with them

> "unless something was pasted over the excluded portion so as to prevent its being read by the jury".

The latest ruling on the question of permitting the jury to consider matter not presented to them by way of evidence, in open court, is found in the January 28th advance booklet of the Federal Reporter, 2nd Series in the decision of the Circuit Court of Appeals for the tenth circuit in the case of *Little v. U. S.*, 73 F. 2nd 861. That decision passed upon the error

and prejudicial effect of permitting the court stenographer, on the court's order, to enter the jury room and in the absence of the defendant, read to the jury the court's instructions.

After reciting the danger of permitting the presence of a stranger in the jury room, the court said:

> "The jury system is founded upon the proposition that disinterested jurors will hear the evidence in *open court, and upon that evidence and that alone,* deliberate among themselves until a verdict is reached." (Citing *So. Pac. v. Klinze,* 65 F. 2nd 85.)

The court commented that even the taking of the indictment to the jury room should not be countenanced, *without an instruction that it is not evidence;* and then expatiated upon the prejudice of such errors, stating that the only way of determining whether the cause of the defendant was not prejudiced, would be by "exploring the deliberations of the jury room, a procedure adopted only in extreme cases and then reluctantly".

So, in the case at bar, it is impossible for this court (or even the trial court) to say what effect the errors herein complained of, had upon the jury.

2. The court erred in refusing to instruct the jury that they were to consider the affidavit only as against the defendant Westbrook.

It is indeed extremely difficult, at the close of a long trial, for counsel familiar with the record, to differentiate between evidence that was admitted as to

all of the defendants and evidence admitted only as to one or more. It is ofttimes difficult for even the court to make such distinction. It is quite obvious, therefore, that it would be impossible for jurors, whose knowledge of the case is confined to the evidence developed upon the trial (particularly in a case where over 300 exhibits are introduced, many of them voluminous in character and difficult of understanding) not only to appreciate the effect of many of such exhibits, but also to recall which exhibits were admitted as against all of the defendants and those which were admitted only against certain defendants.

It was therefore with every intendment of logic and fairness in their favor that the defendants, through their counsel, requested the trial judge (when they realized that it was intended to deliver the Westbrook statement to the jury) to again call the jury's attention to the fact that part of the statement was not in evidence and should not be considered by them in their deliberations, and this was particularly important with reference to the Westbrook statement, because up until the time of their deliberations in the jury room, the jury had no knowledge of that portion of its contents which was excluded from the evidence, the admitted portion having been read to it. It would be expecting far too much to hope that a jury in considering the statement in their deliberations at the close of the trial would pick from that statement only such portions as had been read to them and ignore what followed. The trial court overruled the objections and request of the defendants and its action is stated in the record in the following words:

> "The court overruled said objections of said defendants to said exhibit No. 155 being taken to the jury room, and ordered that the whole of said exhibit No. 155, including the stricken portion, be delivered to the jury for consideration by it during its deliberation, to which said ruling of the court the defendants then and there excepted." (R. 1340.)

We submit that this action on the part of the court is reversible error coming within the purview of the authorities cited and quoted in this section of the brief.

VIII.

THE COURT ERRED IN OVERRULING DEFENDANTS' OBJECTIONS TO U. S. EXHIBITS 297 AND 299 BEING TAKEN INTO THE JURY ROOM AND BEING GIVEN CONSIDERATION BY THE JURY DURING ITS DELIBERATIONS.

(Assignment of Error No. 52, R. 1474-5.)

We have heretofore discussed in this brief the error of the trial court in admitting in evidence U. S. Exhibits 297 and 299, as well as the testimony of their author Goshorn. (Supra, pp. 286-330.) We will therefore limit this phase of the argument to the error, incident to the order made by the court, directing that these exhibits be taken into the jury room for consideration by the jury during its deliberations, without eliminating therefrom those portions thereof which had been excluded from the evidence, and with respect to which certain changes had been directed to be made by the court. The proceedings resulting in the de-

livery of these exhibits to the jury (R. 1335-41), briefly stated, are as follows:

After the case had been submitted to the jury and it had retired to deliberate upon its verdict, it transmitted to the court a request in writing for the delivery to it of Exhibit 155 (Westbrook affidavit) and Exhibits 297 and 299. (R. 1335.) Defendants objected to these latter two exhibits and to each of them being taken into the jury room or considered by the jury during its deliberations upon the grounds:

> "(a) That portions of said Exhibits 297 and 299 had been by the court ordered stricken from evidence and said portions ordered stricken from evidence had not been eliminated from said Exhibits 297 and 299 specifying those portions of said exhibits referring to certain stock as being 'bonus' stock and the jury would therefore be considering evidence out of court, and
>
> (b) That by considering said exhibits, without the jury having the benefit of testimony which had been introduced to explain or contradict the matters appearing on said exhibits, the jury would be giving undue consideration to said exhibits which were introduced only for the purpose of illustration, all of which would be to the prejudice of the defendants." (R. 1340.)

These objections were overruled by the court (R. 1340) whereupon the court

> "*ordered* the said exhibits 297 and 299, together with other requested exhibits sent to the jury room to be considered by the jury during its deliberations *without eliminating from said exhibits the portions thereof that had been ordered stricken from evidence.*" (R. 1340-1.)

Word "bonus" ordered stricken from exhibits.

During the examination of the witness Goshorn on his "voir dire" the following occurred:

"Q. Mr. Goshorn, I notice on this chart, which is Exhibit 297, that in many places you have characterized certain stocks as *'bonus'* stock. Is there any place in the books and records that you have examined that are in evidence where the words 'bonus' stock are used to characterize any of the transactions referred to therein, or is that your own characterization?

A. *That is my own designation.* The books of the McKeon Drilling Company say that some 2,500,000 shares were given for commissions.

Mr. Simpson. I think that the answer of the witness again indicates the fact that he is now testifying and that the exhibit refers to matters which *are his own conclusions.*

The Court. Yes, *you should not designate it 'bonus' stock.* I think that is clear * * *." (R. 601.)

"The Court. Mr. Redwine, I suggest that the witness remark the designation such as 'bonus' stock.

Mr. Redwine. I am willing to have the 'bonus' changed to 'commission' as it is designated on the books of the McKeon Drilling Company.

Mr. Divet. It should not be changed to anything.

The Court. Yes, that may be done. Proceed with your examination.

Mr. Redwine. We will have that stricken—have the word 'commission' substituted for 'bonus'.

Mr. Divet. I think it is just as objectionable as 'bonus'.

The Court. Well, he says the books themselves show he used that term. Is that correct?

A. That is correct.

Q. So, of course, that would be all right. Proceed with your examination, Mr. Redwine." (R. 602-3.)

That the court understood that it had stricken out the word *"bonus"* wherever it appeared upon the exhibit is later shown by questions put to the witness by the court.

"The Court. Now, you account then for 2,500,000 shares in the manner indicated on the remainder of your chart?

A. That is correct.

Q. No. 16 says 'bonus' *which I believe we have agreed was stricken out."* (R. 629.)

With respect to U. S. Exhibit 299, an objection to its introduction in evidence upon the ground that the word *"bonus"* was used therein was overruled. (R. 635.) But later, while the witness was upon direct examination the word "bonus" was ordered eliminated, the record showing:

"The Court. Well, we will eliminate the word 'bonus' for the present as being more or less a conclusion of the witness. It is something that the jury will pass upon. 'Bonus' is of course a word of well-understood significance I guess. Leave it out for the present." (R. 641.)

Word "bonus" not stricken from face of exhibits.

An examination of U. S. Exhibit 297 (R. 595-8) and U. S. Exhibit 299 (R. 636-9) will show that they

are still in the same condition as they were when introduced in evidence. That the word "bonus" had not been stricken out, is further apparent from the objections made before the exhibits were taken into the jury room, as well as from the statement:

> "Said objections of defendants to said exhibits being taken into the jury room were overruled * * * and the said court ordered the said Exhibits 297 and 299 * * * sent to the jury room *to be considered by the jury during its deliberations without eliminating from said exhibits the portions thereof that had been ordered stricken from the evidence.*"

We are not here concerned with the impropriety of the use of the word *"bonus"* upon these exhibits which was given consideration and was discussed by us in Point VI of this brief. (Supra, p. 286.) We are here dealing exclusively with the action of the court in permitting these exhibits to be taken into the jury room during its deliberations without having first deleted therefrom, the word *"bonus"* wherever it appeared, pursuant to the previous order of the court and after the court had itself held that its use was objectionable, as representing solely the conclusion of the witness.

Portions of exhibits improperly construed by jury.

The prejudicial character of the excluded evidence, which the jury was permitted to consider by the action of the court here complained of, can readily be appreciated by reference to the record.

(a) Use of word "bonus" in first summary of Ex. 297. (R. 595-8.)

Item 16. *"Bonus"* common stock distributed by McKeon Drilling Company 1,484,288½.

Items 17-37 (inc.). Relating to stock characterized under Item 16 as *"bonus"* common stock.

Item 39. *"Bonus"* preferred stock distributed by McKeon Drilling Company, Inc. 1,000,000.

Items 40-53 (inc.). Relating to stock characterized under Item 39 as *"bonus"* preferred stock.

(b) Use of word "bonus" in first summary of Ex. 299. (R. 636-9.)

Item 2. *"Bonus"* given to members of $80,000 syndicate, 40,000 common, 40,000 preferred shares.

Items 3 to 10 (inc.). Relating to stock characterized under Item 2 as *"bonus"* given to members. (R. 636-7.)

While the word "bonus" is not mentioned in the second summaries contained in each of these exhibits its "taint" was carried into them, because, each of the second summaries was based upon the first and necessarily included a "realization" from the so-called *"bonus"* stock.

Argument.

The argument made, and the authorities cited, in support of the objection to the admission into the jury room of the whole of Exhibit 155, applies equally to the situation here under consideration, and requires no repetition in this discussion. We must emphasize however that the action of the lower court

in permitting the jury to give consideration to these summaries could not help but result in immeasurable prejudice to the defendants.

As we have before stressed, whether any part of the 4,500,000 shares of Italo stock delivered to McKeon Drilling Company in exchange for its assets was *"bonus"* stock, was the most important, if not the controlling, issue in the entire controversy. If the jury had concluded that no part of this stock was "bonus" stock, the inevitable result to at least these appellants, would have been their speedy acquittal. That the trial court, not only realized that the use of the word *"bonus"* on the summaries, as well as in the evidence of Goshorn, was indefensible, but also appreciated the effect of its use upon defendants, is made manifest by its own rulings, in striking out the word "bonus" wherever it appeared in the summaries, as well as by its observation, that the term reflected only the conclusion of the witness and was a matter for the determination of the jury. Why the trial court permitted these exhibits to be taken into the jury room, over the objections of defendants, and after its attention had been directed to the situation here depicted, is to us inconceivable.

The summaries had been introduced in evidence near the conclusion of the prosecution's case. A number of weeks intervened between their introduction and the close of the evidence. Arguments had been indulged in by counsel occupying no inconsiderable time. The trial had been long drawn-out and an appalling number of exhibits had been introduced, many so complicated in character, that it would have been

humanly impossible for the jury to keep in mind their details. Indeed, it would have been difficult for the trial judge, notwithstanding his experience and training, to constantly recall in a controversy of this magnitude the evidentiary details.

That at the time the exhibits were sent for, the jurors' minds were in a state of uncertainty with respect to the effect of the evidence introduced, is apparent from the very circumstance that these particular exhibits were requested. That after the exhibits reached the jury room, they were seized upon with avidity by the jurors and examined and used by them is obvious. The learning from these exhibits, supposed to represent a tabulation of the evidence in the case, that 1,484,288½ shares of common stock received by McKeon Drilling Company was "bonus" stock, and that large blocks of this stock had been distributed to defendants and others, and other large blocks of this stock had been utilized for the purposes indicated in said exhibits, evidently persuaded the jury that the statements were in accord with the truth and that the defendants should therefore be found guilty. It is impossible to escape from this conclusion.

We have no hesitation in stating that, in our judgment, the conviction of John and Robert McKeon can be logically traced: first, to the admission of these summaries in evidence and the testimony of Goshorn therein, and, secondly, to their examination by the jury before reaching its verdict. In permitting the jury to examine these exhibits without first striking out the word "bonus" wherever used, was in effect authorizing them to give consideration to matters of

great prejudice to appellants, which were not in evidence. That in thus acting, the court committed reversible error is apparent from the authorities cited under Point VII herein (supra, p. 331) to which reference is hereby made.

IX.

THE COURT ERRED IN ADMITTING IN EVIDENCE AGAINST DEFENDANT, JOHN McKEON, IN VIOLATION OF THE BILL OF PARTICULARS, THE RECORDS OF BROWNMOOR OIL COMPANY (U. S. EXS. 32A AND B), THE MINUTE BOOK OF BROWNMOOR OIL COMPANY (U. S. EX. 239), THE FILE OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA INVOLVING THE APPLICATION FOR AND GRANTING OF PERMIT TO BROWNMOOR OIL COMPANY (U. S. EXS. 272, 3 AND 4), THE INCOME TAX RETURNS OF BROWNMOOR OIL COMPANY FOR THE YEAR 1927 (U. S. EXS. 283 AND 284) AND GOSHORN'S SUMMARIES RELATING TO THE BROWNMOOR ACQUISITION. (EXS. 298 AND 299.)

(Assignments of Error Nos. 38, 43, 51 and 61; R. 1437, 1444, 1471 and 1494.)

In view of the fact that the indictment, in setting forth the various steps of the alleged conspiracy, limited a number of the acts therein charged to "some of the defendants",—the defendants McKeon, as well as the other defendants, exercised their right to request the District Attorney to specify, in a bill of particulars, which defendants were intended in each of such charges where the terms "some of the defendants" were used.

Pursuant to such request, which was made in the form of a motion, the court ordered a bill of particulars filed, which was thereafter served upon the de-

fendants. (R. 153-158.) A supplemental bill of particulars was subsequently served. (R. 158-9.)

It is the failure of the trial court, to hold the government's proof, with reference to the said charges, to the terms of the indictment, within the limits prescribed by this bill of particulars, that forms the basis of the above referred to assignments of error and the argument which follows.

The law on the point.

The very existence of a right, accorded a defendant, to move for a bill of particulars and the power of the court to grant such a motion, is a sufficient indication that the government, in presenting its case against an accused, is under duty bound, to restrict its proof within the limits fixed by the bill of particulars, for otherwise the provision which the law makes therefor would be futile and useless.

This rule of law is very definitely fixed by a long line of decisions among which are the following:

U. S. v. Pierce, 245 Fed. 888, 890;
U. S. v. Rosenwasser, 255 Fed. 233, 235;
U. S. v. Adams Express Co., 119 Fed. 240;
U. S. v. Gouled, 53 Fed. 239.

We will take time to quote from only one of these authorities. In *U. S. v. Pierce,* 245 Fed. 888, 890, the rule is expressed as follows:

> "When a bill of particulars is once made and served, *it concludes the rights of all parties who are affected by it* and he who has furnished a bill of particulars, under it *must be confined to the particulars he has specified,* as closely and effectu-

ally, as if they constitute essential allegations in a special declaration."

Similar expressions of the rule are found in:

Loveland on Federal Procedure, Vol. 5, p. 575, Sec. 2120, and
14 *R. C. L.* 191.

The errors committed.

For the purpose of simplifying the consideration of the errors relied upon under this subdivision of our brief, we will divide our discussion under the following titles.

1. The Brownmoor Oil Company transaction; and
2. The $80,000 loan.

The Brownmoor Oil Company transactions.

The allegations of the indictment, with reference to the Brownmoor transactions are: That *some of the defendants,* while acting as directors of the Italo Petroleum Corporation of America, caused the corporation to purchase the assets of the Brownmoor Oil Company for a consideration "far in excess of the actual value of the assets"; that they issued 600,000 shares of the common and 600,000 shares of the preferred stock of Italo Petroleum Corporation, as a part of the purchase price for said assets, and that it was part of said scheme

> "that *some of the said defendants* should and did wrongfully receive a part of said stock so issued * * * and that some of the defendants should and did unlawfully receive the proceeds derived from the sale of said stock to some of the persons to be

> defrauded, for their own use and benefit * * * they, the said defendants not giving any consideration" therefor (R. 29-30)

and that as a part of the said scheme, the said defendants should and did file with the Commissioner of Corporations, an application for permission to issue the said stock, and that they received said permit and issued the stock; that thereafter, they applied for and secured permission to distribute the stock, so issued to the Brownmoor Oil Company, to the stockholders of said company, but that instead of delivering all of the stock to the stockholders of the Brownmoor Oil Company they distributed "some of said stock to themselves and to other persons", who were not stockholders of the Brownmoor Oil Company. (R. 31-32.)

In specifying, in the bill of particulars, who were intended by the terms "some of the defendants" in the charges hereinabove referred to, the District Attorney named several of the defendants, but did not include John McKeon among them. (R. 154-156, Bill of Particulars, 4(c)-4(k).) That this was not an oversight is evidenced by the fact that there is nothing in the record, which in any way connects the defendant John McKeon with the transaction.

During the course of the trial, there were offered in evidence as against all of the defendants named in the indictment, certain records of, and records referring to, the Brownmoor Oil Company, namely: Its minute book (Exhibit No. 239, R. 560-61); the file of the Commissioner of Corporations with reference to the permit authorizing distribution to the Brownmoor stockholders of the stock described in the portion of the indict-

ment now under consideration (Exhibits Nos. 272, 273, and 274, R. 511-512); and income tax returns of Brownmoor Oil Company for year 1927. (Exhibits 283, R. 575.)

These defendants objected to the introduction of each of the exhibits, upon the ground that they were incompetent, irrelevant, immaterial, hearsay, were not binding upon any of the defendants, and did not connect the defendants with any of the charges in the indictment or bill of particulars. (R. 511, 561, 575.) In each instance the objection was overruled and the exhibits admitted in evidence, without limiting their effect to the particular defendants connected therewith in the bill of particulars.

In the light of the failure of the District Attorney to designate John McKeon, in the bill, as one of the defendants initiating or participating in the transactions then under consideration, the above evidence was not competent as against him, and its admission without limiting it to those defendants named in the bill of particulars was, in our opinion, clearly error. And when it is considered that the record is bereft of any evidence that in any way connects John McKeon with these transactions, it would seem apparent that the error was prejudicial to him.

Incidentally the District Attorney must have realized that the introduction of this evidence as against those defendants who were not named in the bill of particulars in connection therewith, would materially assist towards their conviction, otherwise he would not have taken the risk of error, in offering the proof

without the restrictions thereto to which the said defendants were entitled.

By following the record a little further, we find that the documents, so introduced, were to form the basis of the testimony and charts of Goshorn, the "stop gap" witness for the government, which evidence immeasureably intensified the seriousness of the error, as against the defendant John McKeon, by adding to the facts of the records so admitted in evidence, the incriminating *opinions* of the government witness as to the motives of the co-defendants. (Exhibit 299, R. 634-643.)

The objection to the admission of Goshorn's summary into evidence, appears on page 635 of the record and the general objection to his testimony appears on page 592 of the record.

The errors just above specified are covered by assignments of error 38, 43 and 45, which are found in the record on pages 1437, 1444, and 1446, respectively.

The $80,000 loan transaction.

While the acquisition of the Brownmoor properties was being negotiated, a syndicate (referred to in the statement of facts as the "$80,000 Syndicate") headed by defendant, Fred Shingle, as syndicate manager, was formed, to raise $80,000 to be loaned "Italo", to assist in carrying through the purchase.

The *indictment* charged that *"some of the defendants"* (the members of the syndicate which made the loan), wrongfully received:

> "for their own use and benefit, as a bonus for making said loan, 80,000 shares of the capital

stock of said Italo Petroleum Corporation of America, without the knowledge or consent of the persons to be defrauded who were then and there stockholders of said corporation." (R. 29.)

The *Bill of Particulars* named several defendants, as those referred to in the foregoing charge of the indictment, none of whom was John McKeon or Robert McKeon, and thus eliminated the latter defendants from any liability thereunder and relieved them of the necessity of defending themselves against the charge. (R. 154, B. of P. 4a-4b.)

Disdaining to recognize the limitations fixed in his own bill of particulars, the District Attorney proceeded to his proof as though no bill had ever been filed under the order of the court; and, over the repeated objections of the defendants, had government witness George Stratton testify as to his conversations with Wilkes with reference to this syndicate (R. 380), introduced in evidence, through Stratton's identification, the form of the agreement between Fred Shingle, as syndicate manager for the $80,000 syndicate, and the subscribers thereto (Exhibit 142, R. 383), and finally had the government accountant, Goshorn, by his omnibus conclusions, give the transaction the proper criminal tinge. (Exhibit 299, R. 634-643.)

The objection to the testimony of Stratton, and through him the introduction in evidence of Exhibit 142, is contained in the stipulated general objection which appears on pages 373-374 of the record. The stipulated objection was in part as follows:

> "that a standing objection would be deemed to be interposed to each question asked of the witness pertaining to conversations had with particular defendants, or as to documents which the witness testified were submitted to particular defendants on behalf of those defendants who were not present, who did not participate in those matters, on the ground that such testimony is incompetent, irrelevant and immaterial, hearsay and not binding upon them and not referring to any matters alleged in the indictment. And that an exception was allowed in favor of said defendants to each adverse ruling of the court relative thereto."

The objection to the introduction of Goshorn's summary (Exhibit 299) and to his testimony showing the distribution of the syndicate memberships appears in the record on page 634, following the general objection to the Goshorn charge and to his testimony, which appears on page 592 of the record. The objection on page 592 made at the time when Exhibit 297 was offered in evidence was upon the ground among others that the District Attorney was

> "offering the exhibits and the testimony of the witness as against all the defendants, whereas the bill of particulars, furnished by the Government in this case, specifically restricted the testimony to the allegations of the indictment with respect to the matters referred to by the District Attorney, to eight named defendants, entirely omitting from the bill of particulars any reference to any of the other ten defendants, nine of whom are now on trial, * * * in violation of that bill of particulars * * * relied upon". (R. 592.)

And in the same objection, the defendants moved the court:

> "that if this testimony is admitted by the court, it be admitted for the limited purpose as specified in the bill of particulars, and that it is not to be considered for any purpose as against any of the ten defendants who are not named in the bill of particulars, and by reason of not being named therein are expressly excluded therefrom, of having participated in any of the transactions narrated in the exhibit offered, or from having ratified or participated or shared in any of the matters therein referred to".

The objection was overruled and an exception allowed. (R. 593.)

The same general objection, to the introduction of any records with reference to the Brownmoor deal, on the grounds hereinabove stated, appears on pages 262-3-4, of the record, and was made at the time of the offering in evidence of Exhibits 28A, B, C and D, 29, 31 and 33.

The errors complained of under this heading, are reached in the assignments of error, in form of exceptions to the persistent refusal of the trial court to strike the erroneously admitted evidence in so far as it affected the McKeons, and to instruct the jury to disregard such evidence in deliberating upon their innocence or guilt, which latter errors will be discussed under the next heading.

X.

THE COURT ERRED, IN REFUSING TO CORRECT THE ERRORS INCIDENT TO THE ADMISSION OF THE EVIDENCE WITH REFERENCE TO THE BROWNMOOR TRANSACTION, AND TO THE $80,000 LOAN TRANSACTION, BY: 1. DENYING DEFENDANTS' MOTION TO STRIKE SAID EVIDENCE, IN SO FAR AS IT AFFECTED THE DEFENDANT, JOHN McKEON, IN THE FIRST TRANSACTION, AND JOHN AND ROBERT McKEON IN THE SECOND TRANSACTION, AND 2. REFUSING TO INSTRUCT THE JURY THAT SUCH EVIDENCE SHOULD NOT BE CONSIDERED IN DETERMINING SAID DEFENDANT'S GUILT OR INNOCENCE.

(Assignments of Error 38, 43, 61 and 70;
R. 1437, 1444, 1494 and 1504.)

1.

At the close of the government's case, to preserve the points of their objection; to relieve the court of the errors committed, and to save the defendants not named in the bill of particulars from any prejudice in the mind of the jury, due to the admission of such evidence, the defendants, and each of them, moved to strike out each and all of the said exhibits, among others introduced, together with the testimony in relation thereto, on numerous grounds, including the objection incorporated from the objection to Exhibits 28A, B and C:

> "that the defendants did not and were not parties to any of the transactions set out in the books and had no knowledge of any transactions set out in said books, and that there is no proof tending to show that they were, or any of them was, or that they ever authorized any person to enter into the said transactions or become a party to them, or consent to it without the knowledge of them." (R. 264, 686-688.)

The motion of the defendants was denied by the court, and exception allowed. (R. 689.) This action of the trial court, in so far as it affects Exhibits 32A and B, 147 and 239, was noticed in assignment of error No. 38.

And as a last desperate effort to save these defendants from the deleterious effect of the errors hereinabove recited, the defendants offered the following instruction which the trial court refused to give:

> "You are instructed that a bill of particulars has been furnished to the defendants in this case, by order of this court. The purpose of a bill of particulars is to advise the court, and more particularly the defendants, of what facts, in more or less detail, the defendants will be required to meet upon the trial of a case, and the Government is limited in its evidence to those facts so set forth in the bill of particulars, as having been done or committed by any particular defendant. When furnished a bill of particulars it concludes the rights of all parties to be affected by it, and the Government in this case must be and is confined to the particulars they have specified in the bill of particulars as having been done or said by any of the particular defendants. The mere fact, however, that the Government states in the bill of particulars that any particular defendant or defendants did engage in any of the transactions therein alleged is not to be considered by you as any evidence whatsoever that such defendant or defendants did engage in such transaction; but it must be proven by the evidence to your satisfaction beyond a reasonable

doubt that such defendant did knowingly participate in such transaction.

However, the Government is limited and restricted in its evidence to the particulars specified in the bill of particulars and is not permitted to prove that any defendant or defendants not named in the bill of particulars as having engaged in a particular transaction did engage therein. In other words, the effect of the bill of particulars in this regard, is that the Government says that under the evidence the particular defendant did not engage in the particular transaction not specified as having been engaged in by him." (R. 1304-5.) (Assignment of Error 70; R. 1504-5.)

The refusal of this instruction was not compensated by the giving of any similar instruction covering its subject matter. In fact, throughout the lengthy instructions given, there is found no reference whatsoever to the limitations prescribed by the bill of particulars. The only reference in the court's charge to the bill appears on page 1269 of the record, and is contained in the following words, prefacing a detailing of the indictment charges, viz.:

> "The indictment in this case, as amplified and rendered definite by the Bill of Particular charges * * *."

Then in the description following whenever the trial judge came to the words "some of the defendants" he supplied their names from the bill. (R. 1269.)

Thus the jury was forced to struggle through a mass of details, involving numerous complex transactions, into which the government witnesses Goshorn

and Hynes endeavored to breathe an atmosphere of dishonesty and devious dealings; with no measuring stick, to enable them to segregate the charges made as against each separate group of defendants. Thus did the court permit the government to try the defendants on several distinct alleged conspiracies, as though each applied to every defendant, so that any antagonistic opinion of the jurors in one transaction would permeate his opinion as to all of the transactions.

The very persistence of the trial court, in its refusal to limit the evidence in accordance with the bill of particulars, must have impressed upon the jurors' minds that the court was of the definite opinion that all of the evidence sought to be excluded in the manner hereinabove set out, affected the innocence or guilt of each and every defendant. And it would, we believe, be an impossibility, after such a long trial and the introduction of such multifarious and complicated exhibits, for the jury to winnow the wheat from the chaff—to recall which transaction involved this or that defendant.

XI.

THE EVIDENCE WAS LEGALLY INSUFFICIENT TO JUSTIFY A VERDICT OF CONVICTION AGAINST THESE APPELLANTS, AND THE LOWER COURT ERRED IN REFUSING TO GRANT THEIR MOTION TO INSTRUCT THE JURY TO FIND THEM NOT GUILTY.

(Assignments of Error Nos. 17 and 18, R. 1403.)

At the conclusion of the Government's case appellants requested the court to instruct the jury to render a verdict of not guilty. (R. 689-692.) This motion was renewed at the conclusion of all of the evidence. (R. 1262.)

Inasmuch as, in our statement of facts, we have presented to the court the evidence in its fullness, upon which the jury based its verdict finding appellants guilty of the offense charged against them in the fifteenth count of the indictment, no useful purpose would be subserved by further elaborating upon that evidence. With this statement in mind, we believe it only necessary to invite the court's attention, to certain phases of this controversy as to which, in our judgment, there can be no dispute. As heretofore pointed out, the substance of the charge made against these appellants, claimed by the government to have been established, is that they participated in a conspiracy, the object of which was to effect a sale of certain assets of the McKeon Drilling Company, Inc., for a

> "consideration far in excess of the actual value of said assets",

and, as part of such consideration, to cause the issuance to it of 4,500,000 shares of Italo's capital stock; that by secret arrangement, certain of the defendants

who were officers of the Italo and others by whom it was claimed it was dominated, were to and did receive back from the McKeon Company 2,500,000 shares of such stock without consideration, other than that of causing said stock to be issued; and that by such arrangement, defendants intended to and did convert the proceeds derived from the sale of said stock, to their own use and benefit and to the exclusion of the use and benefit of Italo. We state that such was the charge claimed to have been proven against these appellants because the evidence demonstrates that they had no connection with, or knowledge of, any of the other activities referred to or alleged in the indictment, and because, notwithstanding the admission of evidence relating to these other activities, at the conclusion of the evidence the government obviously staked its right to a conviction upon the transactions relating to, and arising out of, the acquisition by Italo of the assets of the McKeon Drilling Company.

In the instant case there is no evidence of any substantiality contradicting or negativing the proofs before the court that the assets of the McKeon Company assigned by it to Italo were greater than the consideration paid to it by Italo, including the value of its stock which constituted a part of the consideration for that transaction. Indeed there is no evidence tending, in the slightest degree, to establish that the value of the other properties acquired by Italo at the time of its reorganization was less than the consideration paid therefor. Furthermore, no evidence was introduced by the government even remotely showing that appellants were ever connected with Italo

American Petroleum Corporation or with the Brownmoor Oil Company or with any of the transactions which resulted in the acquisition of the assets of these companies by Italo Petroleum Corporation.

The condition of Italo, after the reorganization had been effected, is graphically described by the government witness McLachlen. (R. 230.) That the net income aggregating annually approximately one million dollars, previously produced by the McKeon properties, continued long after their transfer to Italo and until curtailment became effective is shown by the witness Byers, an employee of the receiver, who had previously testified as a government witness (supra, pp. 62-3), and this notwithstanding the fact that curtailment became effective November 1, 1929. (R. 850.) The record unequivocally shows that if curtailment had not occurred, the net operating income of these properties would itself within a few years have returned the purchase price paid for them. (Supra, p. 64.)

A brief consideration of the so-called Lyons' tax set-up will prove conclusively that it tends in no respect to support the government's contention. It must be conceded that the major portion of the so-called stock referred to by him as "commission" stock was in fact used by the McKeon Company for the benefit of Italo. This is not only reflected by undisputed and uncontradicted testimony but likewise by many of the items contained in the so-called Goshorn summary. This evidence destroys any sinister aspect that could be imputed to the matter covered by his set-up and demonstrates that in characterizing 2,500,-

000 shares of the stock as "commission" stock he was merely attempting to classify it as stock which had been or was to be used in connection with Italo and the new consolidation and therefore ought not to be given consideration in paying the federal income tax. In this connection the court will recall that this set-up was prepared after much of the stock had been used for the benefit of Italo and after the McKeons had agreed that 2,500,000 shares of the stock, if essential, should in fact be used for Italo and the subsequent consolidation.

Appellants' conduct, in generously giving of their stock and private fortune to protect the stock interests of themselves and those interested in Italo and to avert financial disaster to Italo due to conditions over which they had no control, as well as their attempt to rehabilitate Italo by bringing into existence a larger consolidation, should not be permitted to be utilized as the foundation of a criminal proceeding. As already stated, no direct evidence was introduced tending to show that prior to the acquisition by Italo of the assets of the McKeon Company, any understanding, either secret or otherwise, was had that any of the officials or other persons connected with Italo should be given any part of the McKeon stock.

It is contended by the prosecution, however, that such inference could be indulged in, from the fact that some of the directors and others interested in Italo lated received some of this stock. In the instant case the stock and the proceeds of stock, received by such directors and others, was claimed by defendants to be for the sole benefit of Italo. No evidence to the contrary was introduced.

Until the alleged guilt of appellants was established beyond reasonable doubt, they were protected by the presumption of innocence as well as the presumption of fair and honest dealing. We therefore have a case where on one side we have an inference opposed on the other side by legal presumptions.

The situation just depicted can best be illustrated by the following chart:

Existence of Alleged Agreement Between McKeons and Italo Directors Respecting Secret Profits.

Government's Case.	Defendants' Case.
1. *No direct evidence of such agreement.*	1. *11 witnesses (defendants) denied the existence of any such agreement.*
(This despite number of alleged conspirators and further fact that many employees who would have known of such agreement if it existed were employed by the receiver hostile to defendants.)	(a) Several of those receiving stock from McKeons were not even directors of or connected with Italo. (b) McKeons' claim that they were giving the stock away to sustain Italo and for its benefit is corroborated by the fact that it was practically all used for Italo's benefit.
2. *Government's case depends upon the inference* that since the stock was delivered to directors of Italo after purchase of McKeon Drilling Company's assets, the alleged agreement must have preceded the purchase. This inference is based upon assumption that McKeons would not have delivered this stock as a gift, therefore its delivery must have been accompanied by an ulterior purpose.	2. *Defendants protected by presumptions of law.* (a) The defendants are presumed innocent up to the point where the presumption is overcome by proof of guilt beyond a reasonable doubt. (b) The transactions are presumed to be fair and regular.

It follows therefore, that whatever sinister inference the government might claim can be indulged in, by the evidence introduced by it, must fall as against the presumption of appellants' innocence and the presumption of honest and fair dealing as well as against the uncontradicted and unimpeached testimony introduced by appellants, not only explanatory of the government's case where such explanation was essential to understand the documentary evidence relied on, but consistent alone with appellants' innocence.

As we have already pointed out, there is an utter absence of evidence to prove the existence of the conspiracy alleged in the indictment. Assuming proof of such conspiracy, guilty participation therein by these appellants has not been made out at least to the extent necessary to justify their conviction. Looking at the evidence from the viewpoint of the prosecution, the most that can be said is that, in the absence of the evidence introduced on the part of the defendants, the jury might have been justified in indulging in one of two inferences, one of guilt and the other of innocence. Under such circumstances, however, the inference of guilt would have to fall as against the presumptions of "innocence" and "fair dealing". In *Estate of Brady,* 177 Cal. 537, 540 (a civil case), it was said:

> "The presumption that a person is innocent of crime is very strong and it is not to be assumed in the absence of substantial evidence of the fact that Brady committed perjury in making his affidavit of registration."

In *Ryder v. Bamberger,* 172 Cal. 791, 799, it was said:

> "* * * If there be two inferences equally reasonable and equally susceptible of being drawn from the proved facts, the one favoring fair dealing and the other favoring corrupt practice, *it is the express duty of court or jury to draw the inference favorable to fair dealing.*" (Citing cases.)

In *Kenton County Court v. Bank Lick Turnpike Co.,* 73 Ky. (10 Bush) 529, 536, it was said:

> "Where an act or fact is fairly susceptible of two constructions, one lawful and the other unlawful, that which is lawful should be preferred."

In *Glover v. American Casualty Ins. etc. Co.,* 130 Mo. 173, 186, 32 S. W. 302, it was said:

> "If a party's conduct is equally consistent with innocence or guilt, the presumption is in favor of innocence, always. If an act is as consistent with an honest as a dishonest purpose, the finding must be in favor of the honesty of the transaction."

The case of

People v. Strassman, 112 Cal. 683,

was a prosecution for perjury. The defendant had qualified as a surety upon a bail bond asserting that he was the owner of certain real property. It was claimed by the prosecution that he had no interest whatever in the property. Upon the trial in the court below, the prosecution established that a year before the giving of the bond the property in question stood of record in the name of Hilda Strassman, and upon such foundation relied upon the presumption that Hilda Strassman was still the owner of the property. No evidence was introduced on the part of the defend-

ant. Upon reversing the judgment of conviction, Mr. Justice Henshaw, speaking for the court, said:

> "The only argument advanced by the people is that having shown title in Hilda Strassman more than a year before the date of the alleged crime, the law presumes that she continued to own it until the defendant overcomes the presumption. *But all such disputable presumptions give way before the presumption of innocence* which belongs of right to every defendant, and which remains with him until the prosecution by convincing proof has established his guilt." (Citing cases.)

See also:

Greenwood v. Lowe, 7 La. Ann. 197, 199;

Utah Nat. Bank v. Nelson, 38 Utah 169, 111 Pac. 907;

Constant v. University of Rochester, 133 N. Y. 640, 648; 31 N. E. 26, 29;

Marsiglia v. Marsiglia, 159 Atl. 914, 915;

Fox Film Co. v. Loughman, 233 App. Div. 58, 62, 251 N. Y. Supp. 693.

That upon the record appellants were entitled to a reversal, upon the ground that the evidence is insufficient to sustain the judgment of the court below, is supported by a long line of decisions.

In *Union Pac. Coal Co. v. U. S.,* 173 Fed. 737, 740, it was said:

> "There was a legal presumption that each of the defendants was innocent until he was proved to be guilty beyond a reasonable doubt. The burden was upon the government to make this proof, and evidence of facts that are as consistent

with innocence as with guilt is insufficient to sustain a conviction. Unless there is substantial evidence of facts which exclude every other hypothesis but that of guilt, it is the duty of the trial court to instruct the jury to return a verdict for the accused; and where all the substantial evidence is as consistent with innocence as with guilt, it is the duty of the appellate court to reverse a judgment of conviction." (Citing cases.)

That portion of the decision just quoted was approved in the following cases:

Prettyman v. U. S., 180 Fed. 30, 43;
W. F. Corbin & Co. v. U. S., 181 Fed. 296, 305;
Harrison v. U. S., 200 Fed. 662;
Isabel v. U. S., 227 Fed. 788;
Wright v. U. S., 227 Fed. 855;
U. S. v. Murphy, 253 Fed. 404.

In *Siden v. U. S.,* 9 F. (2) 241, 244, the court said:

"There was a legal presumption that the defendant was innocent of each of the charges in the information against him until he was proved to be guilty beyond a reasonable doubt. The burden is on the government to make this proof. Where all the substantial evidence is as consistent with innocence as with guilt it is the duty of the appellate court to reverse a judgment of conviction."

To the same effect see:

Ridenour v. U. S., 14 F. (2) 888, 892;
Harning v. U. S., 21 F. (2) 508;
Salinger v. U. S., 23 F. (2) 48;
Graceffo v. U. S., 46 F. (2) 852,

where the rule is thus stated:

"It has been held by a long line of decisions in substance that, unless there is substantial evidence of facts which exclude every other hypothesis than that of guilt, it is the duty of the trial judge to direct the jury to return a verdict for the accused and, where all the evidence is as consistent with innocence as with guilt, *it is the duty of the appellate court to reverse a judgment against the accused.*"

XII.

THE COURT ERRED IN OVERRULING DEFENDANTS' OBJECTIONS TO AND MOTION TO STRIKE THE TESTIMONY OF DOUGLAS FYFE, GIVING CONVERSATIONS PURPORTING TO HAVE BEEN HAD WITH JOHN M. PERATA, IN SAN FRANCISCO AND LOS ANGELES.

(Assignments of Error Nos. 25 and 26, R. 1407, 1409.)

The prosecution's purpose in calling Fyfe as a witness is not entirely clear. While he testified that the Italo-American was hard up, the greater portion of his testimony was given over to an expression of his opinion of defendant Wilkes. It is the objection to this testimony and the court's ruling thereon, to which this point of the brief is directed.

The objectionable testimony is taken from two different conversations between the witness and Perata, one occurring in San Francisco, relating to the Italo-American Petroleum Co., the other in Los Angeles, relating to the Italo-Petroleum Corporation of America, and the error as to each is made the subject of a different assignment.

The objectionable testimony.

We will quote first the testimony purporting to relate the conversation in San Francisco and follow it with that given the Los Angeles locale.

> "I had a conversation with Mr. Perata in San Francisco about October 15, 1927, in the presence of Mr. Moore. He informed me that a broker, Mr. Frederic Vincent, had suggested that Alfred Wilkes be brought into the company to get it in better shape. Both Mr. Moore and Mr. Perata expressed some doubt as to the advisability of such a step, and asked me what I knew about Mr. Wilkes. I told them that I only knew Mr. Wilkes by reputation, that he had a reputation for being a promoter.
>
> Objected to as incompetent, irrelevant and immaterial as to the reputation of any one of these defendants. That is not at this time in issue, regardless of whether it is a part of the conversation that might otherwise be admitted, so I move the court to strike that statement of the witness out. Objection overruled. Exception.
>
> The Court. All of the testimony of this witness outside of the presence of the persons he designated is admissible only as against those who particularly were involved up to this time, but it may later involve others, of course, depending on what the future evidence is. Exception.
>
> Q. Will you proceed with the conversation where you left off, Mr. Fyfe?
>
> A. They were expressing some doubt about the advisability of this step, and asked my opinion. I stated that I did not know Mr. Wilkes personally, but I did know of him by reputation; that his reputation was that of a

pure promoter. I think I used the term 'unscrupulous'.

Mr. Wood. I move that the language 'I think I used the term unscrupulous' be stricken out and that the jury be instructed not to consider it. It is purely an opinion of the witness.

The Court. Yes, that should be definite, and the motion is granted, and the jury is so instructed. Further explain, Mr. Fyfe, what did you mean by saying you think?

A. That is my memory of the conversation.

The Court. Very well.

The Witness (continuing). And I believe I cited several things that I had heard about Mr. Wilkes. One thing that I remember telling them was that at one time I had been employed by an Englishman, the manager of the California Amalgamated Oil Company, which had some properties in the San Joaquin Valley. This gentleman had spent some time expressing to me his opinion of Mr. Wilkes." (R. 214-5; Assignment of Error 1407-9.)

The record with reference to the Los Angeles conversation is as follows:

"I had a conversation with Mr. Perata at the Biltmore Hotel in Los Angeles.

Q. What was that conversation, please?

A. Mr. Perata had called me into the room in the Biltmore and asked me how I thought things were going along with the Italo Company. I told him quite frankly that I thought the Italo was getting in very bad shape, that it was generally rumored that the Italo was buying properties at prices very much more than their value.

Mr. West. Object to the answer so far as to what rumors occurred as being hearsay.

Objection overruled. Exception.

A. That men of very bad reputation were being brought into the company. The company was getting a very bad name, and that if he was not careful, the result would be that he and his Italian stockholders would suffer heavy losses. Mr. Perata told me that he realized that the men he was dealing with were, I think, if I may use the expression, pretty tough customers, but that he was watching them and that they wouldn't put anything over on him.

Q. In that conversation was anything said as to the names of the persons who were being brought into the Italo Petroleum Corporation of America by Mr. Wilkes?

Mr. Divet. Objected to as immaterial, and having a tendency indirectly to go into the question of reputation of the defendants and not at all necessary to the end of the inquiry being pursued by the Government.

The Court. Overruled.

Exception.

A. Yes, there were some names mentioned.

Defendants moved to strike out all of the testimony of this witness with regard to the conversation held at the Biltmore Hotel as being wholly immaterial to any charge or issue in this case as to the reputation of anyone. It is immaterial whose names might have been mentioned. It has indirectly reflected upon men who are under indictment here, and their reputation is not in issue unless they put it in issue themselves, and it is wholly immaterial for this witness to

be permitted to state, to give a conversation and through some conversation give his opinion and statements and rumors concerning the reputation of anyone. We move to strike out all of the testimony concerning the conversation at the Biltmore Hotel, because the reputation of any defendant here is not at issue until we make it so ourselves.

The Court. Motion denied.

Exception." (R. 216-218; Assignment of Errors 1409-10.)

Argument.

It is hard to conceive of a case in which such a multitude of errors was crowded into so few pages of testimony. By these two short conversations, there was conveyed to the attentive jury: the opinion of the witness as to the condition of Italo, the opinion of the witness as to the character and integrity of the defendants; and the claim of the witness that it was "rumored" that Italo was paying more for properties than they were worth (one of the leading issues in the case).

All of this "all inclusive" testimony was admitted (over defendants' strenuous objections), in spite of the fact that the reputation of the defendants was not in issue, that no foundation was laid for "opinion" testimony, that neither the witness nor the matter upon which he was being examined came within the rule permitting opinion evidence and that the witness was purporting, from his store of rumor and personal opinion, to answer the very question the jury was selected to answer.

If evidence of this character can be injected into the trial of one accused of crime, the Bill of Rights of our Federal Constitution might as well be scrapped. In face of such a relaxation of the rules of evidence, no accused defendant could successfully defend an indictment.

The purpose sought to be accomplished by the prosecution in thus examining Fyfe was to create in the minds of the jury at the very threshold of the trial the belief that the reputations of certain of the defendants were bad; that they were

> "pretty tough customers, but that he was watching over them and that they would not put anything over on him." (R. 217.)

Although the names of the persons mentioned in the conversation last referred to were not given by the witness, the jury undoubtedly understood that he was referring, among others, to the defendants A. G. Wilkes and Robert McKeon because, as the court will recall, they were elected directors of Italo on March 8, 1928, by its incorporators (R. 236-7, supra, pp. 20-21), and to the defendant John McKeon inasmuch as he was one of the owners of the McKeon Drilling Company the purchase of the property of which was then being negotiated. The prosecution was also attempting to show by this evidence that in the purchase of the various properties sought to be acquired by Italo, it was paying prices greatly in excess of their actual value.

That the government was entirely lacking in authority to introduce testimony bearing upon the rep-

utation of a defendant on trial, unless such reputation is put in issue by affirmative evidence introduced on his behalf, is too well settled to be now the subject of controversy.

Greer v. U. S., 245 U. S. 559, 62 L. Ed. 469;
People v. Mohr, 157 Cal. 732;
State v. Shaw, 75 Wash. 326, at 332, 135 Pac. 20.

To appreciate the prejudice resulting to appellants from the admission of the evidence above quoted it will be necessary for the court to give consideration to the point immediately following which involves an instruction given by the court to the jury addressed to the subject-matter, among others, of "reputation" evidence, which clearly discloses that in response to the express direction of the court in weighing the evidence of defendants, the jury was justified in considering and undoubtedly did give weight to such testimony, to the detriment of defendants.

XIII.

THE COURT ERRED IN GIVING TO THE JURY ITS INSTRUCTION ON THE LEGAL PRINCIPLES APPLICABLE TO THE WEIGHT OF EVIDENCE AND ON THE EFFECT OF REPUTATION TESTIMONY, AND IN REFUSING TO GIVE THE PROPOSED INSTRUCTION REQUESTED BY APPELLANTS UPON THESE SUBJECTS.

(Assignment of Error No. 95, R. 1527.)
(Assignment of Error No. 96, R. 1527-8.)

Appellants John and Robert McKeon introduced evidence showing the excellent reputations possessed by them. (Supra, pp. 209-10.) This evidence was not

contradicted or opposed. Evidence of good character was also introduced on behalf of the defendants Shingle and Brown. The only reputation evidence, therefore *properly* in the record was that given on behalf of the defendants John and Robert McKeon and Fred Shingle and Horace J. Brown.

In order that the jury might be advised respecting the legal principles to be applied by it when giving consideration to and weighing the testimony given by the witnesses (including the defendants) who testified upon the trial, the court gave the following instruction:

> "All witnesses are presumed to speak the truth while on the witness stand. This presumption, however, is a disputable one and may be *repelled* by the manner in which your witness testifies, *by his reputation for truth and integrity, by the probability of his testimony and to the extent to which it is corroborated by known facts in the case,* or by his sympathies with either side of the case, and the extent to which, either favorably or adversely, he might be affected by the result. If a witness has knowingly given false testimony upon a material matter of the case the jury is at liberty to distrust his testimony in other respects, even to the extent of rejecting the whole of his testimony. These principles apply to the defendant when testifying as a witness in his own behalf and to all other witnesses, and the jury may well bear in mind in weighing the testimony of the defendant, the extent to which he may be affected by the result of the trial; and the defendant in a criminal case is not obliged to become a witness in his own behalf, and no inference of guilt can be drawn by the jury because any defendant has not testified at this trial. In the

> Federal courts there is no presumption that the accused is of good character. Neither can he be presumed to be of bad character, but if the good character of the person accused of crime is proven for the traits of character involved in the charges against him and in the case on trial, it must be considered by you in connection with all of the other facts and circumstances brought out by evidence admitted on this trial, and, if after such consideration, the jury is not satisfied beyond a reasonable doubt of the defendant's guilt of the offense for which he is being tried, they should acquit him. But if they are satisfied from all the evidence in the case that the defendant is guilty of the charge for which he is being tried, you should convict him notwithstanding his proof of good character." (R. 1286-7, Assignments of Error Nos. 95 and 89, R. 1527; 1520.)

The above quoted instruction was the only one given by the court upon the subjects to which it relates. (R. 1287.) That the instruction constituted an erroneous statement of the law and was extremely prejudicial to the defendants, particularly the appellants, John and Robert McKeon, will be readily apparent. It was especially injurious, as will hereafter be pointed out, because of the improper evidence given during the examination of the witness Fyfe referred to in the previous point of this brief.

By this instruction the jury was definitely informed that the presumption that a witness (including defendant) was testifying truthfully may be *repelled* by

(a) his reputation for truth and integrity,

(b) by the probability of his testimony, and

(c) to the extent to which it was corroborated by the known facts in the case.

As to each of these propositions the instruction was palpably erroneous. In other words, the very elements that would corroborate and confirm the presumption of truthfulness, the jury was told, were elements which they were justified in taking into consideration to overcome such presumption.

Appellants John and Robert McKeon expressly tendered such issue by affirmative evidence which was not opposed. This evidence supported and confirmed, but did not repel, the presumption of truthfulness attaching to their testimony. The only evidence in the case which by any possibility could justify that portion of the instruction complained of in which the court informed the jury that the presumption of truth might be *repelled* by the "reputation" of a defendant for truth and integrity must have been the evidence given by Fyfe over the objection and against the protest of defendants. The jury therefore was justified in assuming that when it gave this instruction the court was directing attention to the evidence given by the witness Fyfe upon the subject of reputation because it was the only detrimental "reputation" evidence introduced during the trial in the court below.

A proper instruction upon the subjects covered by that portion of the court's charges above quoted was requested by appellants but refused by the court. The instruction is as follows:

"You are the sole judges of the credibility and the weight which is to be given to testimony of

the different witnesses who have testified upon this trial. A witness is presumed to speak the truth. This presumption, however, may be repelled by the manner in which he testifies; by the character of his testimony or by the evidence affecting his character for truth, honesty, and integrity, or his motives; or by contradictory evidence, or showing that he has been convicted of a felony. In judging the credibility of the witnesses in this case, you may believe the whole or any part of the evidence of any witness, or may disbelieve the whole or any part of it, as may be dictated by your judgment as reasonable men. You should carefully scrutinize the testimony given, and in so doing consider all of the circumstances under which any witness has testified, his demeanor, his manner while on the stand, his intelligence, the relation which he bears to the prosecution or the defendants, the manner in which he might be affected by the verdict and the extent to which he is contradicted or corroborated by other evidence, if at all, and every manner that tends reasonably to shed light upon his credibility. If a witness is shown knowingly to have testified falsely on the trial touching any material matter, the jury should distrust his testimony in other particulars, and in that case you are at liberty to reject the whole of the witness' testimony, except in so far as it is corroborated by other credible evidence." (Assignment of Error No. 96, R. 1527.)

That a defendant is entitled to have the jury instructed upon the legal principles and rules governing the construction and weight of evidence is elemental. In no other fashion could his rights be safeguarded

or protected. In the absence of such instruction the jury might well "run wild" when giving effect to the evidence and in passing upon the guilt or innocence of a defendant. In the late case of

Hersh v. U. S., 68 F. (2d) 799,

at page 807, this court, speaking through Presiding Judge Wilbur, stated:

> "It is well settled in the federal court that where a correct proposition of law essential to the proper determination of the issues submitted to the jury is proposed by the defendants, and the same is not given either in substance or effect and the jury is not properly advised thereon by the general charge of the court, the refusal to give such instruction is error. (Citing cases.)"

In the instant case the defendants find themselves in a position more deplorable than if the instruction given by the court had been omitted entirely because here if the instruction as given was followed, which will be presumed, disaster to the defendants would inevitably occur.

Even assuming that with respect to the effect of evidence establishing good character the latter part of the instruction first above quoted correctly stated the law, nevertheless the giving of the instruction must be held to be error because the two elements mentioned in subdivisions (b) and (c) were not subsequently touched upon, and a clear conflict exists between that portion of the instruction referred to in subdivision (a) and the latter part of the instruction. The instruction was therefore conflicting and contradictory and for such reason alone the judgment should be reversed.

In

Nicola v. U. S., 72 Fed. (2nd) 780, 787,

the court said:

> "Where two instructions are given to the jury, one erroneous and prejudicial and the other correct, it is impossible to tell which one the jury followed and it constitutes reversible error."

In

Sunderland v. U. S., 19 Fed. (2nd) 202,

where the court, after holding that an instruction as to the effect of evidence of defendant's good reputation was insufficient, said (p. 215):

> "whatever virtue there was in the charge as given, was completely nullified by another and later portion of the charge * * *."

In

Mills v. U. S., 164 U. S. 644, 41 L. Ed. 584,

the court held that where part of an instruction was erroneous it was not cured by later correct statements of the law, as the jury might have relied on either part.

See, also:

Notary v. U. S., 16 Fed. (2nd) 434.

XIV.

THE COURT ERRED IN OVERRULING DEFENDANTS' DEMURRERS TO THE FIFTEENTH COUNT OF THE INDICTMENT MADE ON THE GROUND THAT AN OFFENSE AGAINST THE UNITED STATES WAS NOT THEREIN STATED.

(Assignment of Error No. 2, R. 1391.)
(Assignment of Error No. 20, R. 1404.)

John McKeon demurred to the indictment on the ground

> "that said indictment as a whole does not, nor does either or any count thereof allege facts or acts which would constitute a violation of any law of the United States." (R. 147.)

Robert McKeon demurred on the ground that:

> "The first and each and every count of said indictment fails to allege facts sufficient to constitute a public offense under the laws of the United States." (R. 137.)

The court's overruling of the demurrer appears on page 188 of the record.

It is the contention of these appellants that the fifteenth count of the indictment is fatally defective in that it purports to charge the defendants therein named with conspiring to commit a conspiracy, and that no such crime exists.

The pertinent portion of the fifteenth count of the indictment charges that the defendants did

> "feloniously conspire, combine and confederate and agree among themselves * * * and with other persons, whose names are to the Grand Jury unknown, to commit certain offenses * * * that

> is to say, that they, the said defendants did * * * conspire, combine, confederate and agree among themselves * * * and with other persons, whose names are to the Grand Jury unknown, as aforesaid, to devise, a scheme and artifice to defraud * * * and for the purpose of executing such scheme and artifice, to place * * * in the Post Office * * * letters" etc. (R. 60.)

The first count is incorporated into the fifteenth count (R. 61), and it charges that the defendants

> "did devise and intend to devise, a scheme and artifice to defraud Italo Petroleum Corporation" etc. "by mailing" etc. (R. 27.)

The language above quoted from the fifteenth count clearly shows an attempt to charge the commission of a conspiracy to commit a conspiracy, a crime unknown to the law. Of course, the first count purports to charge a violation of sec. 215 of the Criminal Code (U. S. C. A. Title 18, sec. 338), which begins:

> "Whoever having devised or intending to devise any scheme or artifice to defraud" etc.

and just as obviously, the fifteenth count is an attempt to state an offense under the general conspiracy statute, namely, sec. 37 of the Criminal Code (U. S. C. A. Title 18, sec. 88) which begins

> "If two or more persons conspire to commit any offense against the United States" etc.

Authorities.

It has been held, in a number of decisions, that a scheme to defraud when entered into by two or more persons becomes a conspiracy. Probably the best reasoned decision so holding point is that of Judge Rudkin of this court in the case of *Robinson v. U. S.*, 33 Fed. (2d) 238.

See, also:

Belden v. U. S., 223 Fed. 726;
Cockran v. U. S., 41 Fed. (2d) 193, 199.

A conspiracy to commit a conspiracy is not a crime, and the fifteenth count of the indictment, therefore, fails to state an offense against the United States.

United States v. Armstrong, 265 Fed. 683, 695.

XV.

THE COURT ERRED IN ADDRESSING DEROGATORY REMARKS TOWARD DEFENDANT, ROBERT McKEON, AND DEFENDANT'S COUNSEL, DURING CROSS-EXAMINATION OF ROBERT McKEON.

(Assignment of Error No. 59, R. 1491-2.)

It will be recalled that at the outset of the argument in this brief, there was presented for this court's attention the refusal of the trial court to recognize the affidavit of prejudice filed against him by the defendants.

As often happens, where there exists a prejudice in the mind of a trial judge, the prejudice of the trial judge in this case showed itself on several oc-

casions (outside of rulings on evidence and the giving and refusing to give requested instructions), notably on the cross-examination of defendant, Robert McKeon, found on pages 1191 to 1192 of the Record, which was as follows:

"Q. I show you a Western Union Telegram under date of April 23, 1929, and ask you if you have seen that before.

A. I seem to remember that telegram, yes.

Q. To whom is it directed?

A. To myself.

Q. And by whom is it signed?

A. By John McKeon.

Mr. Wharton. I offer the telegram just identified in evidence.

Mr. Wood. If the court please, may I ask the witness some general questions here?

The Court. Oh, I don't know. It is a telegram actually received, isn't it?

Mr. Wood. Now, if the court please, if counsel agree that it should be entered——

The Court. Why waste time for a thing like that, Mr. Wood? Mr. McKeon, did you receive that telegram?

A. I believe I did.

Q. Well, did you or did you not?

A. Well, it is a number of years ago. I recall a similar telegram.

Q. Oh, never mind what you recall.

A. Well, I will say that I did.

The Court. All right; that is sensible on your part, let me tell you. Now, then, gentlemen, there is nothing further to that, is there?

Mr. Wood. I wish to make a motion at this time following some general questions of Mr.

McKeon, a motion to suppress this evidence, if I may be allowed so to do.

The Court. Motion denied. Proceed with the examination.

Mr. Wood. Exception.

The Clerk. Government's Exhibit 343."

Defendants moved to suppress this evidence, which motion was promptly denied.

The testimony was given July, 1933 (the trial ended July 23, 1933 (R. 123)), over four years after the receipt of the telegram referred to in the foregoing examinations. There would have been nothing to arouse the resentment of the trial judge, even had the witness no recollection whatsoever of the receipt of that particular telegram. The witness made no effort to deny its receipt. His first answer with reference to it was "I seem to remember that telegram, yes". —nothing evasive in that remark.

Mr. Wood, attorney for another defendant, asked leave to examine on *voir dire*. Without any knowledge of what ground the *voir dire* examination was to cover, the court demonstrated his feeling in the matter by accusing the attorney of seeking to waste the court's time.

Then though witness McKeon had answered, fairly and frankly, the only questions asked about the telegram the trial judge turned to him, intimated that the witness was falsifying, when he said he "believed" he received the telegram, and when the witness testified that he had at least received a "similar telegram", the court let his resentment mount further and again

attacked the veracity of the witness by saying "Never mind what you recall"; and then winds up his examination of the witness by a covert threat in the language:—"That is sensible of you, let me tell you".

It is inconceivable that this little drama was overlooked by the jury and failed to influence them. As was said in the late decision of *Little v. U. S.,* 73 Fed. (2d) 861, 867,

> "Emphasis plays an important role in the transmission of ideas by word of mouth."

And here was the most serious form of emphasis. Not only was an improper emphasis placed upon the testimony of the witness but (1) it was placed there by the trial judge whose every word and even gesture is followed by each member of the jury; (2) it was an emphasis based upon a false premise; and (3) it conveyed the impression to the jury that the witness was attempting to avoid identification of the telegram, whereas a cold analysis of his testimony with the court's remark absent, would convince anyone that the witness was frank and truthful in his answers.

Under the rule as stated in *Lan Fook Kau v. United States,* 34 F. (2d) 86 (this Circuit), this constituted error.

XVI.

THE TRIAL JUDGE COMMITTED PREJUDICIAL ERROR IN REFUSING TO PERMIT DEFENDANTS TO CROSS-EXAMINE GOSHORN RESPECTING OPERATING EXPENSES OF SHINGLE, BROWN & COMPANY AND CONSIDERATION GIVEN BY IT AND ITS MEMBERS FOR McKEON DRILLING COMPANY STOCK.

(Assignment of Error No. 49, R. 1462, 8.)

(Assignment of Error No. 68, R. 1501, 3.)

As has already been pointed out, the summaries, U. S. Exhibits 297 and 299, were prepared by Goshorn, who testified in detail respecting the various items appearing thereon. According to his evidence the second summary (U. S. Ex. 297) correctly disclosed the shares of Italo stock and their proceeds received by the individuals named thereon from the escrow stock transferred to the McKeon Drilling Co. The witness also testified that the item appearing on Exhibit 297, Shingle, Brown & Company, $578,260.63 "was net". (R. 664.)

On cross-examination he was asked the question:

> "Now, do you know from an examination of any of these books and records in evidence that during the year 1929 that the detailed earnings of Shingle, Brown were $1,229,692.09; that after deducting their expenses, operating expenses and other expenses, it left a net profit for that year of $347,840.29?" (R. 664.)

This question was objected to upon the ground that it was not proper cross-examination. (R. 664.) Before the objection was passed upon by the court the witness testified that the sum mentioned represented the *"net amount received"*. (R. 665-6.) After some considerable colloquy between court and counsel the

objection was sustained. (R. 669.) Thereupon the following occurred:

> "Mr. Simpson. Then, am I to understand, so I won't go contrary to the court's ruling, that I am not permitted to question this witness with respect to any matters about any costs, expenses, valuations of services or any such thing which may go to constitute a proper charge or expense against this item of $576,260.63?
>
> The Court. Well, now, that is my view, yes. * * * Well, the objection should be sustained to that question if that is it?
>
> Mr. Simpson. That is the ruling of the court? I don't want to go contrary to it.
>
> The Court. Yes.
>
> Mr. Simpson. Well, we take an exception to the ruling of the court. In view of the ruling, your Honor, I have no further questions to ask." (R. 669-70.)

Goshorn was again called by the government in rebuttal for the purpose of testifying to the profits made by the various stock brokers' pools to whom Shingle, as syndicate manager, had sold some of the common stock of Italo purchased by the so-called big syndicate. (R. 1250-2.)

Upon cross-examination Goshorn was asked the question:

> "Isn't it a fact that for the year 1929 the total earnings of the partnership were $729,904.75?" (R. 1255.) (the page in the record is erroneously marked "1355".)

Objection was made upon the ground that the question was incompetent, irrelevant and immaterial and not

proper cross-examination. (R. 1255.) In explanation of the question Mr. Simpson stated:

> "Apparently the government seems to think there was some significance about making a profit out of some transaction. We expect to show that this was all part of the general business operation, that their gross income was so much, that the operating expenses and other expenses were so much, and get the conclusion as to the net result from all operations." (R. 1255.)

Thereupon the following proceedings occurred:

> "The Court. Well, now, Mr. Simpson, my distinct recollection is that the identical question came up during the examination of the same witness. As I remember I expressed the opinion at that time that it did not make any difference what he made or lost on other matters, if it assumed, and on that the court expresses no opinion, that there is anything culpable with his transactions with respect to this stock, it would not make any difference in the world that he might have made losses on other totally unrelated transactions. I think that is obvious. The objection is sustained.
>
> Mr. Simpson. We take an exception. I was going to inquire of this witness, your Honor, with respect to the gross income, the expenses and the earnings, and I understand from the ruling of the court that I am not permitted to do so. Is that correct?
>
> The Court. Yes.
>
> Mr. Simpson. So that it would be understood that I would make an offer to prove those things along those lines and the Court's ruling is the same, and I take an exception." (R. 1256-7.)

It must be obvious that the rulings of the court complained of were erroneous and that they foreclosed defendants from developing facts and circumstances that would have been of incalculable benefit to defendants.

It was claimed by defendants that the Italo stock received by Shingle, Brown & Company out of the escrow stock belonging to the McKeon Drilling Company, as well as moneys representing the proceeds of the sale of certain of said stock also received by it, were in consideration of services rendered, expenses incurred, and obligations assumed for the benefit of the Italo Petroleum Corporation. Obviously these were matters the defendants had a right to place before the jury, in order that they might give them consideration in reaching a conclusion respecting the character of these transactions. If, as defendants claim, a substantial consideration passed from Shingle, Brown & Company to the McKeon Drilling Company or John McKeon for the stock and money received by it, such transactions would undoubtedly appear to the jury in an entirely different light than if they represented mere gifts or gratuities.

In the absence of the evidence which the court prevented defendants from eliciting upon the cross-examination of Goshorn, the jury might well have believed from the evidence given by Goshorn on direct examination as well as the summaries constantly within their observation, that there not only was no consideration given by Shingle, Brown & Company for the stock and moneys referred to by the witness, but that

they represented transactions entirely different from its normal transactions.

Furthermore, the defendants were legally justified in developing through the cross-examination of this witness the gross income, operating expenses, and net income of Shingle, Brown & Company for 1929, the year during which these transactions occurred, and that its books and records revealed that such transactions constituted a part of its normal business operations. Without having this evidence before it, the jury could readily conclude that the stock and moneys in question represented a profit to the company as against which there could be no offsetting expenses or charges. On the other hand, if the cross-examination had been permitted, the jury would have been enlightened to the extent of being advised not only that these transactions were a part of the firm's general business, but that they should have borne their proper proportion of its overhead, and that the net income derived by Shingle, Brown & Company from all of the business conducted by it during 1929 did not exceed $347,840.29, even when taking into consideration the receipt by it of the $578,260.63 testified to by the witness. With this evidence in the record the jury would have been informed that had the $578,260.63 been eliminated from the firm's profits for 1929, the result would have been a substantial loss in place of any profit.

The law.

The rule that upon cross-examination a witness may be interrogated as to all matters brought out in his

direct examination is of course an elementary one, and the rule that the restriction of this right is prejudicial error is as firmly established.

Minner v. U. S., 57 Fed. (2d) 506 (10th Cir.);
Alford v. U. S., 75 L. Ed. 624;
Heard v. U. S., 255 Fed. 829 (8th Cir.);
Meyer v. U. S., 220 Fed. 822 (5th Cir.).

This principle is stated in substantially the same language in each of the above cited cases, and in each of them it very definitely declared that a full cross-examination upon all questions developed on the direct examination is a matter of absolute right, the abridgement of which constitutes prejudicial error. Probably the most succinct statement is found in *Minner v. U. S.*, supra, and is as follows:

> "A full cross-examination of the witness upon the subjects of his examination in chief, is the absolute right, not the mere privilege of the party against whom such witness is called and denial is prejudicial error."

XVII.

THE COURT ERRED IN GIVING ANY INSTRUCTION TO THE JURY UPON THE RESPONSIBILITY OF DIRECTORS OF A CORPORATION, BASED UPON THE ALLEGED VIOLATION BY THEM OF THEIR FIDUCIARY OBLIGATIONS TO SUCH CORPORATION.

(Assignment of Error No. 103, R. 1534.)

(Assignment of Error No. 104, R. 1535-6.)

(Assignment of Error No. 105, R. 1536-7.)

In its charge to the jury, the court undertook to deliver an exposition of what it understood to be the law relating to the duties of fiduciaries, as well as the

obligations with which they were clothed. It is claimed by appellants that in its conception and interpretation of these principles, the trial court fell into error to the prejudice of appellants, which contention will be given consideration in the next succeeding point. Here we are alone concerned with the error of the court in giving to the jury any instructions whatever upon these phases of the law, the claim of appellants being that none of these instructions had any application whatever to the issues here involved. If the claim here made is sound, it necessarily follows that a reversal of the judgment entered against appellants must inevitably occur, because, as we will quickly point out, if the jury followed these instructions, a conviction might result, even though the jury concluded that no ACTUAL FRAUD was either contemplated by the alleged conspiracy or indulged in by defendants.

The instructions referred to are embraced within the assignments of error above designated and are as follows:

> "You are advised that a director of a corporation occupies a fiduciary relationship to the corporation and to the stockholders. His position is one of trust, and he is frequently denominated a trustee. He is bound to act with fidelity, the utmost good faith, and with his private and personal interests subordinated to his trust duty whenever the two come into conflict. The same is true of its officers and of all other persons who dominate and control the affairs of the corporation. They must at all times deal fairly with those who own or are invited to purchase shares

of the corporation and must fairly disclose all facts which might influence them in deciding upon the value and wisdom of purchasing the stock in such corporation." (R. 1295, Assignment of Error No. 103, p. 1534.)

"While it is true that a contract between a corporation and one or more of its directors is not void or fraudulent, provided the interest of the directors is known to the corporation; directors, or other officers are forbidden to make any profit by selling any property to the corporation of which they are directors or officers without making the fullest disclosure not only to the board of directors of such corporation, but also to those who are solicited to purchase the shares thereof. Directors and officers stand in a trust relation to the company and are bound at all times to act faithfully in the interests of the company and of the stockholders and proposed stockholders. To make any undisclosed profit for himself is fraudulent on the part of a director and to solicit the public to purchase shares without fully informing them of such profit to himself is a fraud upon them.

"There is evidence in this case which, if believed by you beyond a reasonable doubt, will justify a finding that after the organizing of the Italo Petroleum Corporation of America some of the officers effected certain mergers and transferred to the Italo Corporation of America the assets and property of other corporations at a profit to themselves personally without disclosing such fact to those who had bought and were being invited to buy stock therein. It is for you to determine beyond a reasonable doubt from the evidence in the

case whether or not this is the fact, and if you so find it to be a fact, you would be warranted in finding that any defendant so doing did participate in the scheme and artifice to defraud described in the indictment." (R. 1296, Assignment of Error No. 104, pp. 1535-6.)

"It is not unlawful that directors of a corporation have an interest in property sold to the corporation and receive a part of the consideration therefor, even without disclosing such interest in the corporation, provided the transaction as to the corporation is just and reasonable. Directors, however, are forbidden from making any secret profits out of their relation. It is immaterial that the corporation has not been damaged by the transaction; secret profits belong to the corporation for the benefit of its stockholders, and directors are under a duty, if they sell to the corporation, to make the sale without a profit unless they disclose that they are receiving such profit and the fact that the property at the time was worth the purchase price, it in no way relieves the directors of the duties and responsibilities resting upon them as fiduciaries.

"Let me illustrate the matter of secret profits. A prominent business man, I know him well, was president and a member of the board of directors of a life insurance company recently organized, the stock of which had not been sold. The company entered into a contract with a firm of brokers for the sale of the stock for a percentage. The president of the corporation made a secret agreement with the brokers by which he received a percentage of the amount earned by the brokers aggregating some $40,000. Learning of the secret

agreement the corporation brought suit for recovery of this sum as secret profits. The defense was made that the services rendered by the president were worth the amount; that he had resigned a lucrative position with another firm to assist the sale of the stock; that his services were necessary in order to effectuate the sales.

"It was held that the duty of securing the subscriptions was one enjoined by law upon the directors, and that no director could lawfully make any secret profit in the matter of subscriptions. That by making the secret agreement with the broker he acquired an interest that was possibly adverse to his fiduciary duty and he secretly placed himself in a position where conflict might arise between his trust duty and his personal interests. So that it is the law regarding the fiduciary duty, and you will observe in the course of these instructions that he is not permitted to occupy a position where he makes profits that are not disclosed to those whose interests he is bound to protect. In this particular case that claim was established and was paid from the estate long after his death." (R. 1297-8, Assignment of Error No. 105, pp. 1536-7.)

All of these instructions were based upon the mistaken assumption that if the evidence established that the defendants, or some of them, had breached their obligations as fiduciaries, *even though actual fraud was absent,* a verdict of guilty could be rendered, provided the jury found that a conspiracy existed to which the defendants were parties, to effectuate which resort would be had to the use of the United States mails.

That instructions relating exclusively to constructive fraud were legally inapplicable to the issues on trial and should therefore not have been given to the jury seems to us but the statement of an indisputable legal proposition.

The instructions are erroneous because they falsely assume that constructive or presumed "fraud" constitutes a "defrauding" under the mail fraud statute.

Section 215 of the *Criminal Code* under which the indictment herein involved was found provides:

> "Whoever having devised or intending to devise any *scheme or artifice to defraud,* or for obtaining money or property by means of false or fraudulent pretenses, representations or promises * * *." (Title 18 U. S. C. A. sec 338.)

It must be obvious to the court that it would be impossible for any person to engage in any scheme or artifice to defraud unless they first formed a deliberate intent to accomplish one or more of the objects mentioned in the statute. In the absence of such *"intent",* which is the equivalent of *"bad faith",* no offense is or could be committed under the statute. Such scheme or plan constitutes what is defined as *"actual" fraud* in contradistinction to what is known as *"constructive" fraud,* which merely involves a breach of duty arising out of a trust relation unaccompanied by any actual or intentional fraud. The use of the words "scheme or artifice to defraud" found in the statute, themselves import "wilful in-

tent'' and ''bad faith''. ''To defraud'' in Webster's New International Dictionary, is defined to be

> ''to deprive of some right, interest or property by a deceitful device; to cheat; to over-reach.''

The meaning of the words ''to defraud'' was considered in the case of

Hammerschmidt et al. v. U. S., 265 U. S. 182, 68 L. Ed. 868,

where it was said:

> ''To conspire to defraud the United States means primarily to cheat the government out of property or money, but it also means to interfere with or obstruct one of its lawful governmental functions by deceit, craft, or trickery, or at least by means that are dishonest.''

See, also,

Fasulo v. U. S., 272 U. S. 620; 71 L. Ed. 443, at 445.

That intent to defraud must necessarily be present is pointed out in the decisions. In

Horman v. U. S., 116 Fed. 350 (6th Circuit)

the court said this:

> ''A scheme may include a plan or device for the legitimate accomplishment of an object. But to come within the terms of the statute under consideration the artifice or scheme must be designed to defraud. We think, bearing in mind that the term is used to characterize *the guilty purpose and wrongful intent with which the scheme or artifice has been formed by the accused,* there is no difficulty in understanding the legislative purpose in using the term. The intent to

defraud in other statutes is made an element of the offense. It is so in the statute (section 5209) punishing embezzlement and misapplication of the funds of a national bank. The acts are required to be done *with intent to injure or defraud* as distinguished from an innocent purpose in the doing of the same. *We think the term in this statute, as in that, is intended to define the wrongful purpose of injuring another which must accompany the thing done to make it criminal within the meaning of the statute.* (Citing case.) * * * We think this reasoning is applicable here. If the scheme or artifice in its necessary consequence is one which is calculated to injure another, to deprive him of his property wrongfully, then it is to defraud within the meaning of the statute."

In

Durland v. U. S., 161 U. S. 306; 40 L. Ed. 709, the court said:

"In the light of this the statute must be read, and so reading it includes everything designed to defraud by representation as to the past or present or suggestions and promises as to the future. *The significant fact is the intent and purpose.* * * * If the testimony had shown that this Provident Company and the defendant, as its president, had entered in good faith upon that business believing that out of the moneys received by investment or otherwise, made enough to justify the promised returns no conviction could be sustained no matter how visionary might seem the scheme. The charge is that in putting forth this scheme it was not the intent of the defendant to make an honest effort for success, but

that he resorted to this form and pretense of a bond without a thought that he or the company would ever make good its promises. It was with the purpose of protecting the public against all such *intentional* efforts to despoil, and to prevent the post office from being used to carry them into effect, that it was passed."

That a clear distinction exists between *"actual fraud"* and *"constructive fraud"*, and that constructive fraud does not involve deliberate intent to defraud or bad faith is shown by the California Code definitions of these subjects.

See *Sec. 1572, California Civil Code,* defining actual fraud and *Sec. 1573, California Civil Code,* defining constructive fraud.

The instructions are erroneous because they conflict with other instructions given by the court.

The necessity to establish deliberate intent to defraud was given recognition by the trial court in some of its instructions to the jury. Its instructions upon this subject were as follows:

"You will notice from the words of the Statute that the person guilty of its violation must first devise or intend to devise a scheme or artifice to defraud or to obtain money or property by means of false or fraudulent pretenses, representations, or promises; and secondly, for the purpose of executing such scheme or artifice or attempting so to do, place or cause to be placed any letter, circular, or advertisement in the Post Office to be sent or delivered by the Post Office establishment." (R. 1280.)

"The first fundamental question that you should determine in this case is: Was there in fact a scheme to defraud substantially as charged in the indictment? If you answer that question in the negative, you are at an end of the case, and your verdict must be not guilty. If, on the other hand, you answer that question in the affirmative, you should then determine the question whether these defendants or any of them actively, or consciously participated and entered into such scheme, or although not directly participating knowingly aided or abetted the same." (R. 1284.)

"Actual fraud as defined by the law of the state is the suggestion as a fact of that which is not true by one who does not believe it to be true; the positive assertion in a manner not warranted by the information of the person making it, of that that is not true, though he believes it to be true; the suppression of that which is true by one having knowledge or belief of the facts and who is under obligation to reveal it; a promise made without any intention of performing it; and any other act committed to deceive. The intent to defraud must exist at all times." (R. 1288.)

"Fraud is never presumed, and the burden is upon the person claiming fraud to prove it to your satisfaction by competent evidence beyond all reasonable doubt. In the absence of such evidence you are to presume that the defendants were innocent of any wrongful act or fraudulent conduct.

"While it is true that a man is presumed to intend the probable and natural consequences of his own acts, wilfully and intentionally done, yet this

presumption is a rebuttable one and may be repelled by other facts and circumstances in the case and should be taken into consideration by you in connection with all the facts and circumstances of the case. The Government must establish that the necessary effect of carrying the scheme mentioned in the indictment into effect was to defraud the persons of their money or property, and that the defendants knew that such would necessarily be the effect." (R. 1289.)

"The defendants are not on trial for evolving or devising any improvident or impracticable scheme, even though you believe the plan to have been such. They are not on trial for errors of judgment. They are on trial for a criminal offense. An essential element of that offense is an evil or criminal intent which it is incumbent upon the Government to prove to your satisfaction beyond all reasonable doubt." (R. 1290-1.)

These last quoted portions of the court's charge were not applicable and could not properly apply to "constructive" fraud but must have been considered by the jury as affecting only such evidence as was not included in the category of constructive fraud described in the instructions here claimed to be erroneous. Either that or the contradiction between the two sets of instructions, plunged the jury into "confusion worse confounded". The jury could not have followed the erroneous instructions without entirely disregarding those portions of the last quoted instructions, which correctly state the law. In fact for the jury to have followed both instructions in arriving at a verdict would have required of it chameleonic qual-

ities. The authorities supporting the argument under this head are collated elsewhere in this brief on pages 386 and 422.

It is obvious that constructive fraud in its very nature could not be the result of a deliberate scheme or design, and yet in giving to the jury instructions with respect to breach of the obligations of fiduciaries the jury became impressed with the belief that such breaches proved the alleged fraud referred to in the indictment.

While we believe we have already clearly demonstrated the impropriety of the action of the lower court in giving to the jury the instructions complained of, inasmuch as this point and the one following are intimately associated, to avoid duplication we respectfully request the court to examine the next section of our brief as well as the argument therein made and authorities therein cited, in connection with this point.

XVIII.

THE COURT ERRED IN INSTRUCTING THE JURY WITH RESPECT TO CRIMINAL RESPONSIBILITY OF DIRECTORS OF A CORPORATION, BASED UPON THE ALLEGED VIOLATION BY THEM OF THEIR FIDUCIARY OBLIGATIONS TO SUCH CORPORATION.

(Assignment of Error No. 103, R. 1534.)

(Assignment of Error No. 104, R. 1535-6.)

(Assignment of Error No. 105, R. 1536-7.)

While each of the instructions given by the court relating to the above subject matter is covered by a separate assignment of error, grouped together they

constitute the court's instructions upon various phases of the legal obligations resting upon fiduciaries. This situation persuades us that the convenience of the court will be subserved if they are given consideration and discussed collectively. This course, therefore, will be adopted by us. Inasmuch as the instructions complained of are set forth in the preceding point of this brief, we do not deem it necessary to here reproduce them.

Although the statute, which it is claimed the defendants conspired to violate, is predicated upon the existence of a *"scheme or artifice to defraud"* which necessarily involves the elements of "actual fraud" as well as "bad faith" on the part of the accused, it was apparently the viewpoint of the trial court, made manifest by its instructions, that any secret profit made by a director of a corporation, regardless of his good faith or the circumstances under which such profit accrued, constitutes a fraud against such corporation which would come within the purview of the statute referred to and render such director amenable to criminal prosecution.

It was furthermore the opinion of the trial court that in any transaction to which the corporation was a party in which a director was interested, and out of which such director was making a profit, it was the duty of the director regardless of the circumstances of the transaction to make a full disclosure not only to the board of directors of the corporation and its then existing stockholders, but likewise to prospective stockholders including those who were being invited to purchase its stock, irrespective of

whether such invitation emanated from such director or from others who might be strangers or unknown to him, and this notwithstanding such director may have been acting in utmost good faith. The trial court was also impressed with the belief that a transaction between a director of a corporation and a corporation itself as to which a full disclosure was not made, or as a result of which profit accrued to the director, was a void or fraudulent transaction, regardless of the circumstances under which the transaction occurred, and likewise regardless of the question of the *bona fides* of the director. It was in accord with these views that the court, over the objection and exception of defendants, gave to the jury the instructions referred to.

These instructions relate

(a) To transactions engaged in by a corporation in which some of its officers or directors are interested.

(b) To alleged secret profits acquired by a director or officer recoverable by such corporation, and

(c) To the legal necessity for a director to disclose his interest and profit to individuals invited or who propose to become stockholders of such corporation.

That these instructions contain statements of legal principles at variance with the law; that they fail to distinguish between a secret profit which is the result of actual or intentional fraud committed against a corporation and secret profits recoverable by the cor-

poration because of the trust relationship, but not based upon any bad faith upon the part of the director, and that some of the legal principles therein stated are contrary to and at variance with other legal principles therein announced by the court, must be conceded.

In fact, as we will hereafter point out, the hypothetical case described by the court to the jury, which undoubtedly must have effectively impressed the jurors, was based upon an erroneous conception of the legal principles enunciated by the Supreme Court of California in the controversy to which reference was undoubtedly made by the court. The propriety of giving to the jury these instructions will be discussed under appropriate sub-heads.

(a) Element of bad faith ignored by trial court.

No argument should be necessary to sustain the proposition that the obligations resting upon fiduciaries are ofttimes breached, although the fiduciary is acting in absolute *good faith,* and with the *highest motives* and *without any intention to engage in fraudulent conduct.* This situation arises where so-called secret profits are acquired by a director, although the absence of bad faith or ulterior motives is conceded. In such instances the director engages in no reprehensible conduct; he is not amenable to criminal prosecution; he is not even removable from his position for malfeasance or misfeasance in office.

Notwithstanding the absence of bad faith the law permits a recovery of such secret profits by the cor-

poration solely, however, because it will not permit a director to occupy a position that "*possibly*" may be adverse to his fiduciary duty. The integrity of the statement just made is convincingly shown by the case of

Western States Life Insurance Co. v. Lockwood, 166 Cal. 185,

to which the trial court was unquestionably referring when he gave to the jury the illustration above quoted. In the hypothetical case put to the jury by the trial judge it was stated that

> "it was held that the duty of securing the subscriptions was one enjoined by law upon the directors and that no director could lawfully make any secret profit in the matter of such subscriptions. That by making the secret agreement with the broker he acquired an interest which was possibly adverse to his fiduciary duty and he secretly placed himself in a position where conflict might arise between his trust duty and his personal interests. So that it is the law regarding the fiduciary duty and you will observe in the course of these instructions that he is not permitted to occupy a position where he makes profits that are not disclosed to those whose interests he is bound to protect. In this particular case that claim was established and was paid from the estate long after his death." (Supra p. .....)

While in this statement the trial court properly enunciated the principles under which a corporation could recover from a director secret profits acquired by him resulting from commissions paid in connection with the sale of stock, such principles had no relation

whatever to a criminal case where its foundation necessarily must be a *"scheme or artifice to defraud"* which assumes not only *"bad faith"* but *"actual fraud"* on the part of the director.

In the case above cited (to which the trial court was referring) the corporation made a contract with certain brokers under which they were to sell its capital stock for a stated commission. Subsequent to the making of the agreement Arthur Briggs (who had been a resident of Fresno for a number of years where Judge Cosgrave resided) was elected president and director of the corporation. About three months after the contract had been made and after becoming such president and director, in consideration of certain services to be rendered by him to the brokers in connection with the sale of the corporation stock, they agreed to give him 22½% of the commissions earned by them. After the stock had been sold and after Briggs had died, the corporation learning of the agreement between the brokers, brought suit against his estate to recover the commissions paid to him upon the ground that they constituted secret profits. A demurrer to plaintiff's complaint was sustained and judgment entered in favor of defendant. On appeal the judgment of the lower court was reversed.

It must of course be conceded that Mr. Briggs could not have been criminally prosecuted for entering into the agreement under which the so-called secret profits accrued to him, or for collecting and retaining such profits. A reading of the decision of the Supreme Court will disclose that it is not based upon any *"bad faith"* or *"fraudulent conduct"* on the part of

Briggs. The corporation was legally required to pay to the brokers the entire commissions earned. No part of these commissions could have been recovered by the corporation from the brokers. They were recoverable from the estate of Briggs only upon the ground that because of his trust relationship to the corporation, the law prohibited him from acquiring and retaining secret profits resulting from a transaction to which the corporation was a party. That such recovery could be enforced, even though the director exercised the highest degree of good faith, is clearly pointed out in the decision in which it is stated (p. 190):

> "It is well settled that any secret profit obtained by the president or a director of a corporation by reason of any violation or disregard by him of any obligations incident to the fiduciary or quasi-trust relations that he occupies towards the corporation and its stock holders cannot be retained by him but must be accounted for to the corporation. * * *
>
> The law in this regard is so strict that he is not allowed to assume a position, to use the language of the New York Court of Appeals in Seymour v. Spring Forest Cemetery Assoc., 144 N. Y. 333, that is 'possibly adverse to' his 'fiduciary duty' * * *"

And at page 193:

> "*It matters not that the officer is entirely free from any intent to injure the corporation in the slightest degree, acting in fact in the highest good faith throughout, or that his actions really advantage the corporation. No inquiry may be made*

> *into such matter. Any inquiry in this regard is stopped when the relation is disclosed.*" (Italics ours.)

In the case at bar the jurors were justified in believing from the instructions given them, particularly from the assumed hypothetical case, that "*bad faith*" or "*an intent to defraud*" the corporation was an immaterial and unnecessary element in the controversy, in the event they concluded that any of the defendants had breached the fiduciary obligations resting upon them. That bad faith is an indispensable ingredient of the offense alleged is indisputable.

See,

Sandals v. U. S., 213 Fed. 569 (6th Circuit)

in which the contention of the defendants was that because of certain instructions the jury was prevented from exercising free and independent judgment touching the element of good faith. With respect to this subject the court said (p. 574):

> "The ultimate issue of fact was whether the defendants were actuated by an *intent to defraud* when using the mails. (Harrison v. United States, 200 Fed. 662, 665, 666, 119 C. C. A. 78); and this was to be resolved by the jury through an unfettered consideration of all the admissible facts and circumstances, under appropriate instructions of the court. Since the charge of *intent to defraud* was met by a claim of *good faith,* the question is whether, in practical effect, any of the portions of the charge complained of operated to prevent the jury, even when considering the charge as a whole, from exercising a free and

independent judgment *touching the element of good faith.* * * *"

See, also:

Downing v. U. S., 35 Fed. (2d) 454 (9th Circuit).

(b) The court erred in instructing the jury that directors are forbidden from making secret profits out of their relation, although their interest in the transaction from which the profits are derived is made known to the corporation.

As has been shown, the Italo Corporation purchased the assets of the McKeon Drilling Company, paying therefor certain cash and transferring to it certain of its capital stock. While the evidence does disclose that the consideration passing for this property was in excess of its cost to the McKeon Company, the evidence without conflict established that at the time of the transaction the value of the property at least equalled, if it did not exceed, the consideration paid, although this latter element is not here important. It was also demonstrated from the proofs introduced by the prosecution that the McKeon Company assets were acquired by Italo only after the latter had pursued an independent investigation to ascertain their value, was satisfied with their value and that while Robert McKeon was one of the directors of Italo he did not participate in the action of the board of directors resulting in the purchase of such assets.

The evidence further shows that the directors of Italo knew that the McKeon Drilling Company was owned by the McKeon brothers, and that they were also interested in any consideration that would be received by the McKeon Drilling Company for its properties. It is claimed by appellants that certain portions of the court's instructions, quoted under point XVII were entirely inapplicable to the situation disclosed by the uncontradicted evidence and were extremely prejudicial, particularly to the McKeons. If the jury followed these portions of the trial court's charge, it necessarily believed itself justified in convicting the appellants, notwithstanding that the facts referred to were all within the knowledge of Italo and its directors. It is not only within the realms of possibility, but reasonably probable that the jury disregarded all other transactions and centered itself alone upon the purchase of the McKeon Drilling Company properties, in which event the conviction of the appellants could be accounted for under the instructions, of which complaint is here made.

The particular portions of the instructions just referred to contained in the instructions quoted are as follows:

> "(1) While it is true that a contract between a corporation and one or more directors is not void or fraudulent, provided the interest of the director is known to the corporation, directors or other officers *are forbidden to make any profit by selling any property to the corporation of which they are directors or officers without making the fullest disclosure* not only to the board of directors of such corporation, but also to those who

are solicited to purchase the shares thereof. * * * *to make any undisclosed profit for himself is fraudulent on the part of a director* and to solicit the public to purchase shares *without fully informing them of such profit to himself is a fraud upon them.*" (R. 1296, Assignment of Error No. 104, p. 1535.)

The court further instructed the jury:

"(2) There is evidence in this case which, if believed by you beyond a reasonable doubt, would justify a finding that after the organizing of the Italo Petroleum Corporation of America *some of the officers* effected certain mergers and transferred to the Italo Corporation of America the assets and property of other corporations *at a profit to themselves personally without disclosing such fact* to those who had bought and were being invited to buy stock therein. * * *" (R. 1296, Assignment of Error No. 104, p. 1535.)

The court then instructed the jury that

"(3) It is not unlawful that directors of a corporation have an interest in the property sold to the corporation and receive a part of the consideration therefor *even without disclosing such interest to the corporation, provided the transaction as to the corporation is just and reasonable.* Directors, however, are forbidden from making any secret profits out of their relation. It is immaterial that the corporation has not been damaged by the transaction; secret profits belong to the corporation for the benefit of its stockholders, and directors are under a duty, *if they sell to the corporation, to make the sale without a profit unless they disclose that they are receiving such*

> *profit, and the fact that the property at the time was worth the purchase price, it in no way relieves the directors of the duties and responsibilities resting upon them as fiduciaries.* (R. 1297, Assignment of Error No. 105, p. 1536.)

These instructions were clearly objectionable for several reasons. Although Robert McKeon was a director of Italo Corporation he took no part in the adoption of the resolution which authorized the acquisition by Italo of any of the assets of Italo-American Petroleum Corporation, Brownmoor Oil Company or McKeon Drilling Company. In the instructions just referred to nothing was suggested by the court respecting this situation. Inasmuch as Robert McKeon was a *director* of Italo, under the instructions of the court just quoted, the fact that because of his interest in the McKeon Drilling Company, he derived some profit from the sale of its assets to the Italo Company, would itself without any other circumstance, have justified the jury in returning a verdict of guilty, provided the jury believed that a conspiracy existed and this was within its contemplation. These instructions, particularly the instruction quoted in subdivision (3), would justify the jury in finding the appellant guilty, even though the corporation knew of their interest, and even though the property sold to the corporation was worth the purchase price and even though the director was exercising the highest degree of good faith.

Furthermore, two of the instructions last quoted were contradictory and conflicting and it is of course

impossible to determine which was followed. By paralleling the portions of the instructions referred to the conflict becomes readily apparent.

(1) While it is true that a contract between a corporation and one or more of its directors *is not void or fraudulent provided the interest of the directors is known to the corporation* * * * directors or other officers are forbidden to make any profit by selling any property to the corporation of which they are directors or officers without making the fullest disclosure.

(3) It is not unlawful that directors of a corporation have an interest in property sold to the corporation, and receive a part of the consideration therefor, *even without disclosing such interest to the corporation, provided the transaction as to the corporation is just and reasonable.* Directors, however, are forbidden from making any secret profits out of their relation. *It is immaterial that the corporation has not been damaged by the transaction;* secret profits belong to the corporation for the benefit of its stockholders and directors are under a duty, if they sell to the corporation, to make the sale without a profit unless they disclose that they are receiving such profit and the fact that the property at the time was worth the purchase price, it in no way relieves the directors of the duties and responsibilities resting upon them as fiduciaries.

These instructions were directed to important phases of this controversy, were highly prejudicial, and their giving in and of themselves constituted prejudicial error, requiring a reversal of the judgment appealed from.

That a judgment must be reversed where the instructions are contradictory for the reason that the court cannot enter the jury room to determine which instruction was followed by the jury is established

by the authorities cited supra p. 386, as well as the following:

Deserant v. Cerillos Coal R. Co., 178 U. S. 409; 44 L. Ed. 1127, 1133;

Mideastern Contracting Corp. v. O'Toole, 55 Fed. (2d) 909, 911;

Starr v. L. A. Ry. Co., 187 Cal. 270, 280;

Alcamisi v. Market St. Ry., 67 Cal. App. 710, 715;

De Soto v. Pac. Electric, 49 Cal. App. 285, 287.

The instructions are even erroneous statements of the civil liability of directors.

These instructions were erroneous for the further reason that a contract between a corporation and its directors is not *void,* even though their interest is not known by or revealed to the corporation, and even though secret profits are derived therefrom. Under such circumstances, a corporation would be authorized to rescind the contract, or if it preferred, it can affirm the contract and recover the damages sustained, as a result of the fraud. The agreement, however, is not void.

The trial court's error was in failing to distinguish between fraud by which a contracting party is induced to sign a different contract than he believes he is signing, and actual fraud in inducing a contracting party to contract, or constructive fraud created by the breach of a fiduciary duty.

In the first of the above instances, the fraud vitiates the contract, it is void, but in the two latter instances,

the contract is merely voidable. That the purchase of the McKeon Drilling Company's assets, even had it been engaged in by the directors of Italo, in violation of their fiduciary obligations, was not thereby a void contract is established by unconflicting authorities. A few of the authorities are:

Civil Code, State of California, Sec. 1566;
Garcia v. California Truck Co., 183 Cal. 767, 770-3;
Bergin v. Haight, 99 Cal. 52, 55;
Sterling v. Smith, 97 Cal. 343, 347.

The distinction between void and voidable contracts, as hereinbefore described, is clearly discussed by the late Chief Justice Angellotti in *Garcia v. Calif. Truck Co.* (supra).

While in the instruction quoted in subdivision (1) the jury was informed that a contract between a director and a corporation is not void or fraudulent, *if his interest is known to the corporation,* thereby implying that where such interest is not known, the contract is void or fraudulent, the contrary is stated in the instruction quoted in subdivision (3), where the jury is told that if the contract is just and reasonable to the corporation, property may be sold by a director to the corporation, *in the absence of knowledge of his interest.*

Furthermore, the instruction last referred to (subd. 3) is contradictory within itself. It is first stated that the sale of property in which a director is interested to a corporation is lawful, even though the director's interest is not revealed, provided the transaction is

"*just and reasonable*" to the corporation, and it is then stated that a director is forbidden from making any secret profit out of his relation and it is immaterial "*whether the corporation has been damaged by the transaction*", which necessarily means that even though the transaction is "*just and reasonable*" to the corporation, nevertheless, such transaction is fraudulent.

Under the latter part of the instruction quoted in Subd. 3 the jury was informed that if a director sold to a corporation property in which he was interested, even though such interest was known, he could not legally make a profit therefrom, unless he disclosed to the corporation that he was making such profit, and in the absence of such disclosure, a breach of duty was committed, regardless of whether the transaction was *just and reasonable* to the corporation. This is certainly not the law.

On the contrary the authorities hold that a director may sell his property to a corporation when it is known that he is interested in the property, without divulging to the corporation the amount of profit, if any, he is making by the transaction, provided the sale is not induced by false representations of the director, and provided further that his vote was not necessary to consummate the sale.

6a *Cal. Jur.* 290;

Thompson on Corporations, 3rd Ed. Vol. II, Sec. 150;

Burbank v. Dennis, 101 Cal. 90, 98;

Densmore Oil Co. v. Densmore, 63 Pa. St. 43;

San Leandro Can Co. v. Perillo, 84 Cal. App. 627, 631;

Calif. Land Co. v. Cuddeback, 27 Cal. App. 450, 455;

Porter v. Lassen Co. etc., 127 Cal. 261 271.

(c) The court erred in its instructions to the jury with respect to the obligations of directors to future stockholders.

In the instructions above quoted, upon the subject-matter here being considered the court instructed the jury as follows:

> "They (directors) must at all times fairly deal with those who own or are invited to purchase shares of the corporation *and must fairly disclose all facts which might influence them in deciding upon the value and wisdom of purchasing the stock in such corporation.* (R. 1295, Assignment of Error No. 103, R. 1534.)
>
> * * * directors or other officers are forbidden to make any profit by selling any property to the corporation of which they are directors or officers without making the fullest disclosure not only to the Board of Directors of said corporation but also to those who are solicited to purchase the shares thereof. * * *
>
> * * * To make any undisclosed profit for himself is fraudulent on the part of a director and to solicit the public to purchase the shares without fully informing them of such profit to himself is a fraud upon them." (R. 1296, Assignment of Error No. 104, R. 1335-6.)

We have no dispute with the legal proposition that where fiduciaries are themselves inviting the public to become subscribers to the stock of a corporation, any information given by them for the purpose of persuading those so invited to become stock purchasers must be at least substantially in accord with the truth and the facts as they understand and believe them. Anything less than this would be actual fraud. Nor have we any complaint to make of the proposition that a director who purchases property in anticipation of the corporate needs should, before selling it to the corporation, disclose to the directors and such prospective stockholders as he may invite to purchase the stock of the corporation, the amount of profit he contemplates deriving from the transaction and that if the director violates this rule he can be compelled to deliver up his profit to the corporation in a civil suit.

But whatever civil liability may rest upon directors and other fiduciaries of a corporation arising out of the breach by them of these fiduciary obligations with which they are burdened, no incidental criminal responsibility attaches, and no such director or fiduciary can be criminally prosecuted solely and exclusively because of the breach by him of such obligations. Before he can be criminally prosecuted for such a technical dereliction of duty, the interested director must have been concurrently guilty of intentional deceit or dishonesty in the sale to the corporation. In other words, there would have to be added to the elements of constructive or technical

fraud those of actual fraud, namely, a defrauding of the corporation or its stockholders. If such breach were accompanied by any intentional deceit or dishonesty on the part of the fiduciary his conduct would be instantly changed from constructive into actual fraud and criminal responsibility would attach.

The prejudice of the above instructions becomes readily apparent when it is recalled from the record (1) that Robert McKeon, the only McKeon who was a director of Italo, did not participate in the action of the directors in voting the purchase of the McKeon Drilling Company properties, (2) that the McKeon Drilling Company purchased its properties long prior to his becoming a director of Italo, and (3) that the record is bereft of any testimony even intimating any misrepresentation as to the value of the properties being transferred. The instructions hereinabove quoted, therefore, are clearly erroneous in conveying to the jury the fallacious impression that criminal liability attaches by the sole fact that a director interested in the property transferred to a corporation fails to divulge the amount of profit which he will receive therefrom, and thereby permitting the jury to infer that such a director might be criminally liable without any deceit or dishonesty being practiced by him.

These instructions, however, do not correctly state the law and were particularly prejudicial to Robert and John McKeon in their application to the purchase of the McKeon Drilling Company's property. None of the property of the McKeon Drilling Company was

acquired by it or by any of the McKeons for the purpose of reselling it to Italo. The Italo Corporation was negotiating for the purchase of valuable oil properties then and theretofore owned and operated by a going concern. Even had Robert McKeon participated in the deliberations of an action taken by the board of directors of Italo resulting in the purchase of these properties, it is not the law that he or the McKeon Drilling Company would be required to furnish either to the corporation or to its stockholders or proposed stockholders the cost price of these properties to the McKeon Drilling Company in order to permit the corporation or such stockholders to be advised of the profit being made by the McKeon Drilling Company representing the difference between the capital cost of its properties and their selling price.

These instructions, so far as they apply to the McKeons and the McKeon Drilling Company are antagonistic to and find no support in the authorities. Neither the McKeons nor the McKeon Company were in the position of promoters or directors acquiring property for the express or intended purpose of reselling it to the Italo Company for a consideration in excess of that paid by them for such property. It is only in such instances that the instructions given by the court would be justified.

In this connection the court will recall that eliminating the vote of every director whom it could be claimed was even remotely interested in any of the properties being acquired, nevertheless their purchase was authorized and approved by the majority vote of the directorate.

Not only did the court give these instructions to the jury but refused to give an instruction upon the subject matter which in our judgment correctly stated the law. This instruction is set forth in Assignment of Error No. 109 (R. 1540) and is as follows:

> "You are instructed that it is lawful for directors of a corporation to be interested in properties sold to the corporation and to be interested in the consideration which the corporation pays for such properties, and it is lawful for such officers and directors not to disclose to the corporation, or its other officers or directors, their interest in the transaction or in the consideration paid by the corporation, if the transaction as to the corporation is just and reasonable at the time it was authorized, made or approved. In other words, secrecy as to the interest of directors and officers in a transaction is lawful, provided the transaction as to the corporation is just and reasonable; that is to say, provided the properties acquired by the corporation are of a value commensurate with the consideration which the corporation pays therefor. Therefore, if you believe from the evidence that the value of the properties transferred to the corporation by the McKeon Drilling Company was commensurate with the value of the money and stock which the Italo Corporation of America paid therefor, the fact, if you find it to be a fact, that one or more of the officers or directors of the Italo Corporation of America was interested in the transaction, in that such officer or director received a part of the consideration paid by the Italo Corporation of America for said properties, would not make the transaction fraudulent but on the contrary said transaction would be lawful."

The accuracy of this instruction is established by the authorities already cited.

XIX.

THE COURT ERRED IN REFUSING TO INSTRUCT THE JURY THAT IN CONNECTION WITH THE SYNDICATE SUBSCRIPTIONS THE DIRECTOR HAD TO EXERCISE BAD FAITH IN ORDER TO BE HEREIN CRIMINALLY RESPONSIBLE.

(Assignment of Error No. 114, R. 1543.)

Upon the subject above referred to the defendants requested the court to give to the jury the following instruction.

> "You are instructed that a director of a corporation may advance money to it, may become its creditor, may take from it a mortgage or other security, and may enforce the same like any other creditor, subject only to the obligation of acting in good faith. It is not a fraud upon the corporation or its stockholders for a director to fail to disclose to the corporation, or to the other directors, that he is the real lender, where the loan is nominally made by another person or by a syndicate of which the director was a member. In the absence of proof of bad faith it was not a fraud upon the Italo Petroleum Corporation of America for any director of the Italo Petroleum Corporation of America to be a member of the syndicate which loaned $80,000 to the Italo Petroleum Corporation of America; nor was it wrongful for him to fail to disclose this fact to the corporation or its stockholders. * * *"

We have already shown that "bad faith" is a necessary element of the offense which it is claimed was the subject-matter of the alleged conspiracy. The re-

quested instruction should therefore have been given. The remainder of the requested instruction, reads as follows, viz.:

> "There was no presumption that the face value of the capital stock of a corporation is its real value. The fact that the price paid by the syndicate for the 6,000,000 shares of capital stock of the Italo Petroleum Corporation of America may have been less than its par value or less than its actual value did not make the contract or transactions illegal or fraudulent."

The correctness of the portions of the foregoing instructions first quoted is upheld by the Supreme Court of California in the case of

Schnittger v. Old Home etc., 144 Cal. 603,

in which in passing upon the legality of a loan made by directors of a corporation through the medium of a dummy lender, the court said (p. 607):

> "It was not a fraud upon the corporation, or upon the other members of the Board, for these directors not to disclose the fact that they were the real parties who were loaning the money, or that the person in whose name the transaction was had was merely a figurehead. It was no violation of their duty as trustee to loan the money in the name of another rather than in their own, unless it could be shown that thereby the corporation sustained some detriment or they obtained some undue advantage over the corporation."

See, also:

2 *Thompson on Corporations,* 3d Ed., secs. 1352-3;

3 *Fletcher—Ency. of Corporations* (Permanent Ed.), Sec. 907.

The last quoted portion of the instruction is supported by the decision in the case of *Castle v. Acme Ice Cream Co.,* 101 Cal. App. 94, 101.

The fact that the government in its successful efforts to convict the defendants made a considerable point of the fact that directors of the Italo became members of the syndicates formed to make loans to the corporation discloses the pertinency of the instruction and the injury suffered by the defendants through the court's failure to give it.

CONCLUSION.

We believe that we owe the court an apology for the undue length of this brief. We feel, however, that the extent of our efforts may be justified not alone because of our desire to assist the court in reviewing the evidence, both oral and documentary, but because of the importance of this controversy to our clients and our conviction that if properly presented the necessity for reversal of the judgment of the lower court will be made manifest.

We believe that within the pages of this brief we have established:

(a) That because of the prejudice existing in the mind of the trial judge, established by the affidavit of prejudice filed herein prior to the trial of this controversy, Honorable George Cosgrave was legally prohibited from presiding at the trial of this controversy.

(b) That during the course of the somewhat protracted trial in the court below, errors of substantiality were committed by the trial judge, in the admission and rejection of evidence, highly prejudicial to appellants.

(c) That during the course of his charge to the jury the trial court not only misconceived the legal principles applicable to the controversy but gave to the jury principles of law both erroneous and contradictory.

(d) That the evidence introduced upon the trial was not legally sufficient to overcome the presumption of innocence and to establish the guilt of the appellants beyond a reasonable doubt.

It is respectfully but with confidence submitted that the judgment of the lower court should be reversed.

Dated, San Francisco,
March 6, 1935.

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